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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

AZ CORP COMMISSION
DOCKET CONTROL

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE REVIEW AND
POSSIBLE REVISION OF ARIZONA UNIVERSAL
SERVICE FUND RULES, ARTICLE 12 OF THE
ARIZONA ADMINISTRATIVE CODE.

Docket No. RT-00000H-97-0137

IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS.

Docket No. T-00000D-00-0672

**NOTICE OF FILING
TESTIMONY**

AT&T Communications of the Mountain States, Inc. and TCG Phoenix give notice of the
filing of the public version of the Reply Testimony of Dr. Debra J. Aron and the Reply
Testimony of Dr. Ola Oyefusi.

RESPECTFULLY SUBMITTED this 5th day of February, 2010.

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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - Chairman
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IN THE MATTER OF THE REVIEW AND
POSSIBLE REVISION OF ARIZONA UNIVERSAL
SERVICE FUND RULES, ARTICLE 12 OF THE
ARIZONA ADMINISTRATIVE CODE.

Docket No. RT-00000H-97-0137

IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS.

Docket No. T-00000D-00-0672

REPLY TESTIMONY OF

DR. DEBRA J. ARON

On Behalf of

AT&T Communications of the Mountain States, Inc. and TCG Phoenix

February 5, 2010

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DOCKET No. RT-00000H-97-0137
DOCKET No. T-00000D-00-0672
AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC.
AND TCG PHOENIX
REPLY TESTIMONY OF DR. DEBRA J. ARON

I. Introduction

Q: ARE YOU THE SAME DR. DEBRA J. ARON WHO SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING?¹

A: Yes, I am.

Q: WHAT IS THE PURPOSE OF YOUR REPLY TESTIMONY?

A: I am responding to the Direct Testimony of Mr. Douglas Denney filed on behalf of Eschelon Telecom of Arizona, Mountain Telecommunications, Electric Lightwave, McLeodUSA Telecommunications Services, tw telecom of Arizona, and XO Communications Services (hereafter referred to collectively as "Joint CLECs"); the Direct Testimony of Douglas Garrett on behalf of Cox Arizona Telcom; the Direct Testimony of Douglas Duncan Meredith on behalf of the Arizona Local Exchange Carriers Association ("ALECA"); the Direct Testimony of Lisa Hensley Eckert on behalf

¹ Direct Testimony of Dr. Debra J. Aron on Behalf of AT&T Communications of the Mountain States, Inc. and TCG Phoenix, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Aron Direct Testimony*), December 1, 2009.

1 of Qwest Corporation and Qwest Communications Company (hereafter referred to as
2 "Qwest"); the Direct Testimony of Don Price filed on behalf of Verizon California,
3 Verizon Business Services, and Verizon Long Distance (hereafter referred to as
4 "Verizon") ; the Direct Testimony of Dr. Ben Johnson on behalf of the Residential Utility
5 Consumer Office (hereafter referred to as "RUCO"); and the Direct Testimony of Wilfred
6 Shand on Behalf of Staff of the Arizona Corporation Commission (hereafter referred to as
7 "Staff").²

² Direct Testimony of Douglas Denney on Behalf of Eschelon Telecom of Arizona, Inc.; Mountain Telecommunications, Inc.; Electric Lightwave, LLC; McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services; tw telecom of Arizona LLC; and XO Communications Services, Inc., *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Denney Direct Testimony*), December 1, 2009; Direct Testimony of Douglas Garrett on Behalf of Cox Arizona Telcom, L.L.C., *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Garrett Direct Testimony*), December 1, 2009; Testimony of Douglas Duncan Meredith on Behalf of the Arizona Local Exchange Carriers Association, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Meredith Direct Testimony*), December 1, 2009; Direct Testimony of Lisa Hensley Eckert on Behalf of Qwest Corporation and Qwest Communications Company, LLC, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Eckert Direct Testimony*), December 1, 2009; Direct Testimony of Don Price on Behalf of Verizon, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Price Direct Testimony*), December 1, 2009; Testimony of Ben Johnson, Ph.D. on Behalf of the State of Arizona Residential Utility Consumer Office, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona*

1
2 **Q. DO YOU HAVE ANY COMMENTS ABOUT THE DIRECT TESTIMONY**
3 **OVERALL IN THIS CASE?**

4 A. Yes. In the Telecommunications Act of 1996 ("TA96"), Congress established a new
5 paradigm for the communications industry in which markets were opened so as to bring
6 the benefits of competition to consumers. As part of that new paradigm, implicit
7 subsidies were to be eliminated or replaced with explicit subsidies.³ Congress recognized
8 that for competition to function effectively and enhance economic efficiency and
9 consumer welfare, the old system of cross-subsidies from some providers to other
10 providers could not and should not be perpetuated.

11 Now, over 14 years since the passage of TA96, the communications industry has in fact
12 undergone a sea-change as competition has developed in ways perhaps not even imagined
13 in 1996. Competition is fundamentally intermodal, technological innovation has

Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Johnson Direct Testimony*), January 6, 2010; Direct Testimony of Wilfred Shand, Public Utilities Analyst Manager, Utilities Division, Arizona Corporation Commission, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, (hereafter *Shand Direct Testimony*), January 8, 2010.

³ Telecommunications Act of 1996, § 254(e). See also, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *In the Matter of High-Cost Universal Service Support and Federal-State Joint Board on Universal Service et al.*, Before the Federal Communications Commission, WC Docket No. 05-337 and CC Docket 96-45 et al., FCC 08-262, (released November 5, 2008), (hereafter *2008 NPRM*), Appendix A, ¶ 169.

1 broadened our concepts of communications, and every-day communications vastly
2 transcend traditional concepts of voice telephony.

3 Remaining among the last vestiges of the pre-1996 marketplace, however, are the very
4 stubborn remnants of the legacy access system, which favors some technologies over
5 other technologies, and forces some consumers to subsidize other consumers not on the
6 basis of need or equity, but on the basis of which technology they choose for their
7 communications needs.

8 This proceeding is about effecting long-overdue policy change in Arizona to harmonize
9 intrastate access policy with the goals of the Telecommunications Act and with the
10 realities of technological change and competition, by taking a measured step toward
11 relieving Arizona consumers and the Arizona communications marketplace from the
12 harmful impact of inflated intrastate switched access charges. The decision the
13 Commission makes in this proceeding will affect all communications providers in
14 Arizona, whether they are participating in this proceeding or not. Rather than protect the
15 interests of any carriers in this proceeding or seek to balance the interests of any of the
16 parties, I encourage the Commission to look beyond the carriers' interests to the
17 objectives and directives of the Telecommunications Act and to the overriding goals of
18 consumer welfare and economic efficiency. The current system of distorted access rates

1 is unstable, inefficient, harmful to competition, harmful to efficiency, and, therefore,
2 harmful to consumers. Indeed, at this point, it is even harmful to the carriers that it was
3 originally intended to support.

4 The arguments made by the CLECs to protect their current immunity from access rate
5 reductions and by Qwest to protect its excessive intrastate access rates in Arizona are
6 simply unavailing or incorrect. All LECs have market power with respect to switched
7 access service. It is proper public policy to regulate those prices, and a reasonable level at
8 which to regulate them is the one that has been in effect for nearly a decade in the
9 interstate jurisdiction for the same carriers for the same functionality as intrastate access.
10 Any higher level is simply a monopoly markup imposed by local exchange companies on
11 long distance carriers and their customers.

12 ALECA's arguments, although largely correct in principle, are made in support of a
13 proposal that is inadequate to address the problems it articulates, or to achieve the goals it
14 identifies. Indeed ALECA is well aware that its proposal would not address significant
15 arbitrage issues, because it explained as much in its white paper and discovery responses
16 issued before the direct testimony. Staff similarly articulates the right principles but seeks
17 to address them with an inadequate solution.

1 Access reform requires regulatory conviction, because it requires regulators to confront
2 the magnitude of the implicit subsidies that have been embedded in the current intrastate
3 access rates and find an explicit source of revenues to replace them, either through retail
4 rate increases or universal service support. The fact that the amount of implicit subsidies
5 embedded in current intrastate access rates is (according to ALECA) material in Arizona
6 is not a justification for shying away from attacking the problem in earnest, however. On
7 the contrary, the greater the amount of implicit subsidy in a system, the more harmful it is
8 to efficiency and competition, and the more urgent it is that it be corrected. I encourage
9 this Commission to engage the issues in this proceeding by looking beyond the rhetoric
10 and embracing the facts and analysis. They lead to the conclusion that meaningful,
11 comprehensive access reform that reduces the rates of all ILECs to their interstate levels,
12 and caps all CLECs' rates at the ILECs' levels, is a reasonable step toward long-overdue
13 compliance with the directives and goals of TA96; is consistent with sound public policy
14 and economic principles; can be achieved without undue rate shock to consumers; is in
15 the public interest; and, indeed, is necessary.

1 **II. Response to the Direct Testimony of Mr. Douglas Denney on Behalf of Joint CLECs**

2 **Q: DO YOU HAVE ANY GENERAL OBSERVATIONS ABOUT THE JOINT**
3 **CLECS' TESTIMONY?**

4 **A:** Yes. The Joint CLECs currently are the recipients of a monopoly markup imposed on
5 IXC's (and IXC's' customers) via the CLECs' excessive intrastate access rates, which are
6 protected by the imprimatur of the regulator, and sustained by their market power over
7 switched access to their customers. Reducing this markup would impose a greater
8 requirement for each CLEC to earn its revenues from its own customers by competing
9 effectively in the marketplace—a prospect that is decidedly less attractive and more
10 burdensome to CLECs than being allowed to continue collecting a monopoly stream of
11 income. The accusatory and inflammatory tone of the Joint CLECs' testimony is not
12 surprising when viewed in that context, but the content of their testimony cannot gain
13 validity by virtue of the invective with which it is stated. In fact, I will explain that the
14 joint CLECs' arguments are factually incorrect, economically incorrect, irrelevant, and/or
15 entirely unsupported, and in some cases have long been discredited. Specifically,

- 16 • The Joint CLECs' accusations of hypocrisy by AT&T are backward—in fact, unlike
17 the joint CLECs and other parties in this proceeding, AT&T is proposing to take the
18 same medicine it has prescribed for others. AT&T's proposal is to reduce all LEC
19 access rates to interstate rates, including its own.
- 20 • The Joint CLECs' claim that regulating their access rates would be “radical” and
21 counter to recent trends tending toward less regulation is unfounded. The purpose of
22 access reform is to unwind the effects of legacy regulation and reduce regulatory

1 burdens on consumers and competition so that competition can function most
2 effectively in retail markets. To this end, CLECs' rates for the identical functionality
3 as intrastate switched access have been regulated for years in the federal (interstate
4 switched access) and state (local call termination) arenas and, in the last decade, more
5 and more states are regulating intrastate switched access as well. CLECs' interstate
6 access rates, which are rates for the same functionality as intrastate access, have been
7 capped at ILECs' rates by the FCC since 2001, and AT&T proposes only to cap
8 CLECs' intrastate rates at the same level. CLECs' reciprocal compensation rates for
9 local call termination, which is also the same functionality as interstate and intrastate
10 switched access, are regulated by the Arizona Commission, at far lower rates still.

- 11 • The Joint CLECs' claim that the conditions that led the FCC to cap CLEC access
12 rates in 2001 no longer apply is incorrect. The FCC recognized that CLECs have
13 market power with respect to switched access service. They still have that market
14 power, notwithstanding the competitive nature of the retail local exchange
15 marketplace, because no amount of competition in the retail market renders switched
16 access a competitive service. The fact that CLECs' intrastate access rates exceed
17 those of the ILECs is evidence of that market power. The FCC has reiterated its
18 conclusions since its initial decision capping CLEC rates and each order or proposed
19 order since that time incorporates caps on CLEC rates that are equal to or lower than
20 the current caps.
- 21 • The Joint CLECs' cries of poverty vis à vis the other carriers in this proceeding are
22 unavailing, particularly in light of the fact that the amount of access revenues that
23 would be forgone to the CLECs due to AT&T's proposed access reform in Arizona
24 would constitute less than one tenth of one percent of their total annual revenues from
25 their global operations, according to their own revenue figures provided in their
26 testimony.
- 27 • The Joint CLECs' comments regarding special access margins are entirely irrelevant
28 to this proceeding, which is not about intrastate special access rates in Arizona, let
29 alone interstate special access rates in Arizona and other states.
- 30 • The Joint CLECs' laundry list of reasons that their costs would be higher than those
31 of the ILECs are not dispositive of any conclusion that their costs are actually higher.
32 In fact, the Joint CLECs have not persuaded any state commission or the FCC that
33 their costs exceed those of the ILEC with whom they compete.
- 34 • CLECs' attempts to postpone access reform and delay its implementation (for them)
35 through a variety of proposals ignore the fact that CLECs have enjoyed eight years in
36 Arizona in which they have not been subject to the partial reform imposed on Qwest's

1 intrastate rates, and ignore the fact that CLECs have known or should have known
2 since 1996 that their intrastate access rates were subject to reductions by regulators.
3 Indeed, CLECs have advised their investors of this risk since at least 1997. If they
4 have not modified their business models in anticipation of this event it is not the fault
5 of Arizona consumers, who should not be made to wait even longer for the benefits of
6 access reform.

- 7 • The CLECs' attempts to inflate the cost of switched access that should be imposed on
8 IXCs by claiming that IXCs are cost-causers of the costs of the loop is no more valid
9 than asserting that IXCs are cost-causers of the cost of a telephone handset—and that
10 IXCs should therefore subsidize handset manufacturers. The CLECs' argument is
11 incorrect and the FCC and economists have long rejected it.

12
13 **Q: DO YOU HAVE ANY OVERARCHING COMMENTS ABOUT THE CLECS'**
14 **DISCOVERY MATERIALS?**

15 **A:** Yes. Since filing my Direct Testimony I have become aware that the average composite
16 access rates provided in discovery by tw telecom were based on calculations performed
17 by tw telecom that I believe are erroneous, and which resulted in tw telecom understating
18 its average intrastate and interstate access rates by about half. Tw telecom calculated its
19 average composite intrastate access rate by dividing its intrastate access revenues not by
20 local switching minutes, as Qwest did and as is common, but by the sum of local
21 switching *plus tandem switching minutes*.⁴ Dividing the access revenues by local
22 switching minutes puts the rate on a called-minute-of-use basis. Tw telecom's approach,
23 which I have never seen used before, has no clear interpretation or meaning. The

⁴ See tw telecom Response to Staff Data Request STF 1.1.

1 resulting rate cannot be compared to Qwest's rate because the rates are not calculated on
2 the same basis.

3 After identifying this error I further researched the rates reported by the LECs. I was able
4 to nearly replicate Qwest's rates using the most recently available ARMIS data. ALECA
5 and the CLECs other than tw telecom did not report sufficient details of their data and
6 their calculations in discovery for me to verify whether or not their calculations are
7 correct or whether they suffer from the same defect as does tw telecom's.⁵ I have asked
8 AT&T to request through the discovery process that the other CLECs provide the
9 necessary additional information underlying their reported average access rates.

10 The figures that I reported in Table 2 of my Direct Testimony were those provided by the
11 CLECs, without any corrections or modifications. Once discovery is received from the
12 CLECs I will be able to examine them and if my concerns are verified by the data I will
13 provide a revised version of Table 2 in the Rejoinder round of testimony.

14 **A. Regulating CLEC Intrastate Rates Is Not "Radical"**

⁵ See CLECs' Responses to Staff Data Request STF 1.1 and ALECA's Response to Staff Data Request STF 1.1.

1 Q: MR. DENNEY ASKS THE COMMISSION TO "BE CAUTIOUS OF TAKING
2 THE RADICAL STEP OF PRICE REGULATING CLECS."⁶ IS REGULATING
3 ACCESS RATES RADICAL?

4 A: No, it is not. In fact, CLECs' interstate access rates have been regulated for years by the
5 FCC, as I noted in my Direct Testimony, and CLECs have intrastate access rate tariffs on
6 file and subject to Commission jurisdiction. Moreover, AT&T's proposed rates are not
7 novel for the CLECs: they are the *same rates that CLECs are already required by the*
8 *FCC to charge, and are presumably already charging, for interstate access.* By setting
9 intrastate rates at interstate levels, the Commission will only be conforming the intrastate
10 rate to the already-required interstate limit for CLECs.

11 Q: BUT IS IT NOT TRUE THAT TA96, WHICH GAVE BIRTH TO CLECS, WAS
12 INTENDED TO REDUCE PRICE REGULATION, AND THAT RECENT
13 TRENDS POINT TOWARD LESS REGULATION AND MORE COMPETITION,
14 AS MR. DENNEY CLAIMS?⁷

15 A: This is true with respect to retail local exchange services. It is not true with respect to
16 switched access services, where the trend has been toward increased rather than decreased
17 price regulation, because reducing switched access charges decreases the distortions and
18 burdens imposed on the telecommunications industry from the legacy regulatory structure
19 of intercarrier transfers that preceded TA96. Requiring CLECs to reduce their excessive
20 access rates is therefore part of and necessitated by the drive toward less regulation and

⁶ Denney Direct Testimony, p. 5.

1 more competition, because competition on the merits cannot be fully achieved as long as
2 some carriers using some technologies must pay monopoly markups on access services
3 while competitors using other technologies do not.

4 The trend toward more, rather than less, regulation with respect to switched access is for
5 good reason—as I explained in my Direct Testimony, both ILECs and CLECs possess
6 market power for both originating and terminating switched access services. The source
7 of this market power does not derive from any entry barriers or failure of competition in
8 the local exchange marketplace. Rather, it stems from legal constraints on differential
9 retail long distance pricing and the institutional idiosyncrasies of the provision of
10 switched access service.⁸

11 **Q: PLEASE EXPLAIN WHY THESE FACTORS CREATE MARKET POWER FOR**
12 **CLECS IN TERMINATING ACCESS.**

13 **A:** When a customer makes a toll call to a particular telephone number, the IXC selected by
14 the originating caller must deliver the call to the terminating LEC that serves the called
15 telephone number, regardless of the price that LEC charges for terminating access. The

⁷ Denney Direct Testimony, p. 5.

⁸ The Joint CLECs hint in discovery that they plan to argue that special access provides adequate competition to switched access so that regulation of switched access rates is unnecessary. See Joint CLECs' First Set of Data Requests, DR.6. This is incorrect. While special access does provide an alternative to switched access for customers who have traffic volumes large enough that it is economical to build or purchase a dedicated facility to bypass the LEC's switch, this alternative cannot provide enough discipline on switched access prices to drive them to cost-based levels. I provided a formal proof of this proposition in AT&T Responses to Joint CLECs' First Set of Data Requests, DR.6, which is attached hereto as Exhibit DJA-R1.

1 IXC does not have a choice of terminating provider. That choice is made solely by the
2 customer receiving the call. However, the IXC must recover the costs that it incurs for
3 switched access expenses in the prices of long distance calls. As long as the IXC must
4 charge the same amount for calls that are terminated to customers of high-access-fee
5 LECs as it does for calls that are terminated to customers of low-access-fee LECs, the
6 LECs have limited incentive to reduce their access fees and limited discipline against
7 increasing them. Each LEC, by unilaterally increasing its access fees, would have a
8 diluted effect on the IXC's overall average costs that it must recover, and therefore would
9 have a diluted effect on long distance prices, and a diluted effect on customer usage. This
10 dilution means that neither the end-user customer placing the call, nor the LEC charging
11 the access fee, is required to confront the full effect of the terminating LEC's price
12 increase, thereby limiting downward pressure on access prices.

13 To understand why the market does not function effectively to discipline access prices, it
14 is useful to describe how the market would have to work in order to create pricing
15 discipline. The way the market would be expected to create pricing discipline in an
16 access market without any regulatory constraints or logistical frictions can be most easily
17 seen with an example.

1 Suppose that LEC A charged 5¢ per minute for terminating access and LEC B charged
2 2¢. Now consider an IXC's customer, Mr. X, making a call to a customer of LEC A.
3 LEC A's terminating access price would affect Mr. X's decision about whether to call his
4 friend, the customer of LEC A if, when he makes the phone call, he receives a real-time
5 message telling him that (i) the party he is calling is a customer of LEC A; (ii) that LEC
6 A charges the IXC 5¢ a minute for the call; and (iii) that this charge will be billed back to
7 Mr. X for this call. In that scenario, Mr. X would have the opportunity to decide not to
8 complete the call (or to shorten the call) and LEC A would lose revenues. In addition,
9 Mr. X could communicate to his friend that he is reluctant to call him because of the high
10 charges assessed by the friend's LEC. Mr. X may also ask his friend to call him back, so
11 that his friend bears the cost of the call himself. These factors would put some (if not
12 perfect) pressure on the customers of LEC A to switch LECs, and therefore some (if not
13 perfect) pressure on LEC A to decrease its access rates.

14 Under these same conditions, if Mr. X were to call a customer of LEC B, the message Mr.
15 X would receive would inform him that this call would cost 2¢ a minute for termination
16 fees (or a usage price that builds in the 2¢ fee), and Mr. X would have less incentive to
17 terminate or shorten the call than he would when calling customers of LEC A. In
18 addition, LEC C may have an incentive (again not a perfect incentive) to offer yet lower
19 access charges in order to appeal to customers who otherwise would find their friends,

1 associates, or customers hesitant to call them. Under these conditions, there would be a
2 mechanism by which LECs with lower terminating rates could attract customers and
3 those with higher rates could lose customers and minutes, thereby imposing some
4 pressure on their terminating access rates.

5 **Q: DO THE CONDITIONS YOU HAVE IDENTIFIED THAT WOULD DISCIPLINE**
6 **THE PRICE OF TERMINATING ACCESS HOLD IN THE MARKETPLACE**
7 **TODAY?**

8 **A:** No. First, I understand that there are no systems in place that could provide callers with
9 the necessary information at the start of each toll call. Thus, the IXC cannot identify for a
10 caller the terminating LEC or its access rate at the start of the call. Second, it is my
11 understanding that even if systems were developed to enable an IXC to pass such
12 information to callers in an acceptably non-intrusive fashion,⁹ IXCs are not permitted to
13 pass along access charges differentially—that is, IXCs are not permitted to charge
14 different prices for long distance service depending on the rates charged by the called
15 party's LEC. As I noted in my Direct Testimony,¹⁰ the Telecommunications Act of 1996
16 requires all IXCs to comply with geographic rate averaging—which applies to both

⁹ It is also necessary for the functioning of this market mechanism that the real-time information system not be unacceptably intrusive from the perspective of customers, because if the pricing information were materially intrusive into the process of making a call, it would be practically infeasible for IXCs to charge the access rates back to their customers even if they are legally able to. Some or all customers would insist on forgoing the information (and the differentiated pricing), perpetuating the situation in which LECs can exert market power in switched access because customers would not have adequate pricing information to make informed, price-responsive decisions.

¹⁰ *Aron Direct Testimony*, pp. 86-87.

1 intrastate and interstate toll services—and the FCC has instituted a geographic rate
2 averaging policy that precludes IXCs from charging consumers different prices based
3 upon the called or calling party's serving LEC.¹¹

4 These facts defeat the market's ability to impose competitive discipline on terminating
5 access prices.

6 **Q: DOES THE FCC AGREE WITH THIS ANALYSIS?**

7 **A:** Yes. As articulated by the FCC:

8 [I]t appears that the CLECs' ability to impose excessive access charges is
9 attributable to two separate factors. First, although the end user chooses
10 her access provider, she does not pay that provider's access charges.
11 Rather, the access charges are paid by the caller's IXC, which has little
12 practical means of affecting the caller's choice of access provider (and
13 even less opportunity to affect the called party's choice of provider) and
14 thus cannot easily avoid the expensive ones. Second, the Commission has
15 interpreted section 254(g) to require IXCs geographically to average their
16 rates and thereby to spread the cost of both originating and terminating
17 access over all their end users. Consequently, IXCs have little or no ability
18 to create incentives for their customers to choose CLECs with low access
19 charges. Since the IXCs are effectively unable either to pass through
20 access charges to their end users or to create other incentives for end users
21 to choose LECs with low access rates, the party causing the costs – the end
22 user that chooses the high-priced LEC – has no incentive to minimize

¹¹ Report and Order, *Policy and Rules Concerning the Interstate, Interexchange Marketplace and Implementation of Section 254(g) of the Communications Act of 1934, as amended*, Before the Federal Communications Commission, CC Docket No. 96-61, FCC 96-331, (released August 7, 1996), ¶ 9.

1 costs. Accordingly, CLECs can impose high access rates without creating
2 the incentive for the end user to shop for a lower-priced access provider.¹²

3 **Q: DO CLECS HAVE MARKET POWER IN TERMINATING ACCESS EVEN IF**
4 **THE CUSTOMER BEING CALLED HAS MORE THAN ONE TELEPHONE**
5 **PROVIDER?**

6 **A:** Yes. Even when the called party has multiple phone lines (such as wireline and wireless,
7 for example) and the caller can therefore choose between different providers to terminate
8 the call (for example, the caller may be able to choose to call the other party on her
9 mobile phone or wireline phone), the terminating provider retains market power. This is
10 because the IXC must terminate the call to the telephone number called, even if the called
11 party has other telephone numbers using other providers. The IXC does not have the
12 opportunity to choose which of the customer's telephone providers to whom to terminate
13 the call, and the calling customer does not have the incentive to choose the one with the
14 lowest terminating access fees, for the same reasons I have already discussed.

15 **Q: DOES THE FCC AGREE WITH THIS ANALYSIS AS WELL?**

16 **A:** Yes. As the FCC observed in 2005,

¹² Seventh Report and Order and Further Notice of Proposed Rulemaking, *In the Matter of Access Charge Reform and Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Before the Federal Communications Commission, CC Docket No. 96-262, FCC 01-146, (released April 27, 2001), (hereafter *CLEC Access Charge Reform Order*), ¶ 31. See, also, Notice of Proposed Rulemaking, *In the Matter of Developing a Unified Intercarrier Compensation Regime*, Before the Federal Communications Commission, CC Docket No. 01-92, FCC 01-132, (released April 27, 2001), ¶ 14.

1 Exacerbating the issue of inefficient rates is the problem of terminating
2 access monopolies. Even when an end user takes service from two
3 providers, *e.g.*, wireless and wireline, the originating carrier must deliver
4 the call to the terminating carrier with the telephone number dialed by the
5 calling party. Other carriers seeking to deliver calls to that end user have
6 no choice but to purchase terminating access from the called party's LEC.
7 Originating carriers generally have little practical means of affecting the
8 called party's choice of access provider, and the called party's LEC may
9 take advantage of the situation by charging excessive terminating rates to a
10 competing LEC.¹³

11 **Q: HOW DO CLECS HAVE MARKET POWER IN ORIGINATING ACCESS?**

12 **A:** With respect to originating access, the market power is again not a result of entry barriers
13 or any failure of competition in the local exchange marketplace, but a result of legal
14 constraints on differential pricing and the institutional facts of the marketplace. To
15 discipline prices for originating access, and again considering my same example, the IXC
16 would have to charge a different price for long distance calls if its customer subscribes to
17 LEC A than if he subscribes to LEC B.

18 Hence, confronting the end-user customer with the relevant price signals would require
19 that the IXC could charge different rates to customers purely on the basis of the LEC to
20 which they subscribe, a form of differential pricing that I understand is also not permitted
21 by the same rate averaging rules I referenced earlier. As long as such differential pricing

¹³ Further Notice of Proposed Rulemaking, *In the Matter of Developing a Unified Inter-carrier Compensation Regime*, Before the Federal Communications Commission, CC Docket No. 01-92, FCC 05-33, (released March 3, 2005), (hereafter *Inter-carrier Compensation Reform FNPRM*), ¶ 24.

1 is not permitted by regulation, customers have no incentive to choose their LEC on the
2 basis of the originating access fee that the LEC charges to IXC's, and the ability of the
3 market to discipline originating access fees is impeded.

4 **Q: MR. DENNEY ARGUES THAT DESPITE THE FCC'S 2001 DECISION TO**
5 **REGULATE CLECS' INTERSTATE ACCESS RATES, A RATE CAP IS NO**
6 **LONGER WARRANTED BECAUSE OF "CHANGES IN THE**
7 **TELECOMMUNICATIONS INDUSTRY"¹⁴ UPON WHICH THE FCC**
8 **PREDICATED ITS CONCLUSIONS. HAS HE ACCURATELY**
9 **CHARACTERIZED THE FCC'S VIEWS?**

10 **A:** No. The FCC's analysis of the market for switched access services is consistent with the
11 one I have articulated here, and, as I quoted earlier, the FCC reiterated its conclusion that
12 terminating access is a monopoly at least as recently as 2005, in its *Intercarrier*
13 *Compensation Reform FNPRM*.¹⁵ Mr. Denney argues that in the 2001 *CLEC Access*
14 *Reform Order*, the FCC identified two market "developments" that would "make
15 exchange access (or switched access) markets competitive,"¹⁶ and he argues that these
16 "developments" have now come to pass.¹⁷ In fact, the FCC did not indicate in the 2001

¹⁴ Denney Direct Testimony, pp. 35-39.

¹⁵ See, for example, *Intercarrier Compensation Reform FNPRM*, ¶ 24. Regarding originating access, the FCC has not indicated any retreat from its 2001 conclusion that originating access is a monopoly service (See, *CLEC Access Charge Reform Order*, ¶ 29), and as recently as 2008 then-chairman Martin proposed eliminating originating access charges entirely. See, *2008 NPRM*, Appendix A, ¶ 229.

¹⁶ Denney Direct Testimony, pp. 37-38.

¹⁷ These preconditions are (1) marketing alliances between IXC's and LEC's; and (2) IXC entry into local exchange markets. Mr. Denney cites to ILEC deployment of toll services, once they had received Section 271 approval from the FCC, and the "mergers between major IXC's (and CLEC's) and ILEC's" as evidence that these preconditions have now been met, and concludes that these developments "rebut any suggestion that CLEC's

1 *CLEC Access Reform Order*, or in any other order of which I am aware, that these or any
2 other “market developments,” if they came to pass, would make the access market
3 competitive; on the contrary, the FCC found in the same order that CLECs’ ability to
4 impose excessive access charges “is attributable to” two specific factors: the fact that
5 access charges are paid by the IXC, which has “little practical means of affecting the
6 caller’s choice of access provider,” and regulatory restrictions on rate deaveraging;¹⁸ i.e.,
7 the very same factors I discussed above and which still exist today.

8 The FCC’s subsequent discussions regarding market power for switched access services
9 have continued to focus on the same two factors that it identified in 2001 (and that I
10 identified as the source of CLECs’ market power regarding switched access) and have
11 reiterated the FCC’s conclusions that terminating access is a monopoly service. Indeed,
12 although Mr. Denney makes much of the fact that in the *CLEC Access Reform Order* the
13 FCC characterized its decision to regulate CLECs’ interstate access rates as a
14 “transitional” measure,¹⁹ the fact is that the FCC continues to cap CLECs’ interstate
15 switched access rates, and the FCC’s most recent proposal to reform interstate switched

might exercise market power and prevent IXCs from entering the market.” See, *Denney Direct Testimony*, pp. 38-39.

¹⁸ *CLEC Access Charge Reform Order*, ¶ 31.

¹⁹ *Denney Direct Testimony*, pp. 35-36.

1 access fees in 2008 seeks to implement even more restrictive measures on how ILECs and
2 CLECs price interstate access.²⁰

3 **Q: HAVE STATE COMMISSIONS EVEN MORE RECENTLY REACHED THE**
4 **CONCLUSION THAT CLECS POSSESS MARKET POWER IN THE**
5 **PROVISION OF SWITCHED ACCESS THAT MERITS CONSTRAINTS ON**
6 **THEIR INTRASTATE ACCESS RATES?**

7 **A: Yes. For example, last year in Massachusetts CLECs made the same arguments as Mr.**
8 **Denney is putting forward here. The Massachusetts commission rejected them and, as I**
9 **explain later, ordered CLECs' rates to be capped at the rates of the major ILEC, Verizon.**
10 **According to the Massachusetts Department of Telecommunications and Cable,**

11 Evidence strongly shows that CLECs have market power in providing
12 intrastate switched access service. The unique market characteristics of
13 switched access make it virtually impossible for competition to exist.
14 These same conditions prompted the FCC to cap CLEC rates for interstate
15 switched access in 2001.²¹

16 * * *

17 Given the clear structural failure of the access market with regard to
18 terminating charges, the Department finds that the lack of competitive
19 forces has given CLECs market power. The Department similarly finds

²⁰ 2008 NPRM, Appendix A, ¶¶ 186-206.

²¹ Final Order, *In the Matter of Petition of Verizon New England, Inc., MCI Metro Access Transmission Services of Massachusetts, Inc., d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc., d/b/a Verizon Business Services, Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance, and Verizon Select Services, Inc. for Investigation under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Before the Commonwealth of Massachusetts Department of Telecommunications and Cable, D.T.C 07-9, (hereafter *2009 Massachusetts Order*), June 22, 2009, p. 9.

1 that in the originating market, the failure of existing competitive forces to
2 discipline rates results in CLECs having market power. The presence of
3 market power overcomes the presumption that CLEC rates are just and
4 reasonable when determined by market forces.²²

5 Similarly, in January of 2010, the New Jersey Board reached similar conclusions. The
6 Board found that

7 [S]witched access service is a monopoly because there is no ability for an
8 IXC or its customers to avoid excessive access charges. The Board
9 concurs with Sprint's argument that LECs have a monopoly over access to
10 their end users, which has permitted a situation where CLECs have
11 charged access rates well above the rates that ILECs charge for similar
12 services.²³

13 * * *

14 [T]here is no material difference in the functionalities used to provide
15 interstate and intrastate switched access and, as a result, any disparities in
16 the Intrastate and Interstate Access Rates should be eliminated.
17 Additionally, the CLECs and ILECs in New Jersey have been charging
18 interstate rates and using interstate rate structures for all interstate calls in
19 New Jersey since the FCC issued its CLEC Rate Cap Order. ... [T]he
20 FCC's approach has been successful and the FCC has not since changed
21 its approach to the pricing of Interstate Access Rates. ... [T]here is no
22 evidence that interstate access rates capped by the FCC eight years ago
23 have caused any CLEC to exit the market.²⁴

²² 2009 Massachusetts Order, p. 17. (Citations omitted.)

²³ Order, *In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, Before the State of New Jersey Board of Public Utilities, Docket No. TX 08090830, February 1, 2010, (hereafter *2010 New Jersey Order*), p. 27.

²⁴ *2010 New Jersey Order*, p. 27. (Citations omitted.)

1 Q: DO THE ACTUAL ACCESS PRICES CHARGED BY CLECS APPEAR TO BE
2 DISCIPLINED BY THE MARKET?

3 A: No. According to the Joint CLEC rates computed in Mr. Denney's own testimony, the
4 average intrastate access rate Joint CLECs charge for switched access in Arizona is well
5 over double the average intrastate access rate charged by Qwest.²⁵

6 Moreover, Mr. Denney's assertion that CLEC rates were not reduced after Qwest's
7 reductions because "there was no reason" to²⁶ is an admission of CLECs' market power.

8 If a CLEC competed with the ILEC in the provision of a particular service, there would
9 be downward pressure on its price if the ILEC lowered its own price. If the CLEC has no
10 market power, its prices for switched access service would not be expected to exceed the
11 ILEC's rate in its geographic area *even if it has higher costs*, because customers would
12 not choose to purchase a comparable service at a higher price if they had a choice. The
13 fact that CLECs have sustained higher prices than Qwest and felt "no reason"
14 (in Mr. Denney's words) to respond to Qwest's lower prices by decreasing their own
15 switched access rates is because Qwest's intrastate switched access service does not
16 compete with the CLECs' switched access services and vice versa—i.e., the CLECs
17 possess market power with respect to switched access service.

²⁵ Denney Direct Testimony, Table 1, p. 19. Using Mr. Denney's methodology, Qwest's average rate based on its current intrastate tariffed rates is \$0.018192, compared to an average of \$0.042525 for Joint CLECs (average of terminating and originating rates).

²⁶ Denney Direct Testimony, p. 20.

1 **B. CLECs' Access Rates Should Not Be Exempted from Regulation**

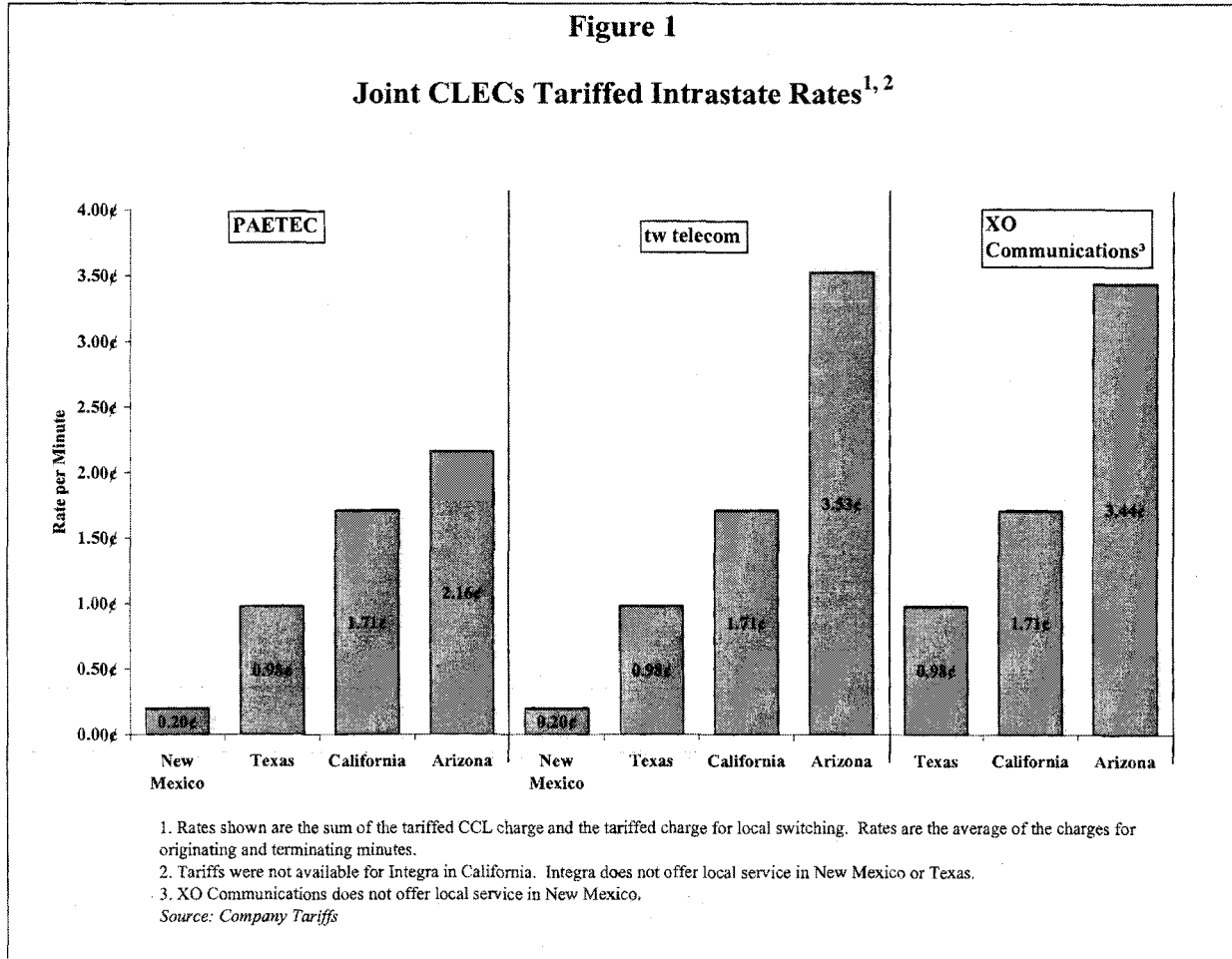
2 **Q: MR. DENNEY ASSERTS THAT "NO PARTY HAS DEMONSTRATED THAT**
3 **CLEC ACCESS RATES ARE UNJUST OR UNREASONABLE."**²⁷ **IS THAT**
4 **TRUE?**

5 **A:** No, it is not. Mr. Denney made his statement before he had seen any of the testimony
6 evidence submitted in this proceeding, so his statement was a bit premature, at best. In
7 fact, I demonstrated in my Direct Testimony that CLECs' intrastate switched access rates
8 are excessive, above Qwest's intrastate rates, and above the rates they themselves charge
9 for the same functionality in Arizona in the interstate jurisdiction.²⁸ Joint CLECs'
10 intrastate rates are also above the rates *they themselves* charge for the same
11 functionality—intrastate switched access—in other, neighboring, states, as exemplified in
12 Figure 1 below.²⁹ I also explained in my Direct Testimony and elaborated here that
13 CLECs possess market power with respect to switched access services. As long as
14 CLECs have market power in the provision of access services, and their rates are
15 demonstrably above those of the ILECs with whom they compete, their rates are not just
16 and reasonable from an economic standpoint, and intervention by the Commission is
17 appropriate.

²⁷ *Denney Direct Testimony*, p. 18.

²⁸ *Aron Direct Testimony*, p. 10, Figure 1 and p. 39, Table 2.

²⁹ In Figure 1, I have compared the tariffed Carrier Common Line charge and Local Switching rates in a number of states where Joint CLECs operate. These two elements usually represent the largest portion of access expenses.



1 Q: MR. DENNEY PROVIDES A LAUNDRY LIST OF REASONS THAT CLECS'
2 COSTS WOULD BE HIGHER THAN ILECS' COSTS.³⁰ HAS HE
3 DEMONSTRATED THAT CLECS' COSTS ARE IN FACT HIGHER THAN
4 ILECS' COSTS?

5 A: No. Whatever the merits of his observations regarding CLECs' costs, they do not add up
6 to a demonstration that the costs of any CLEC are in fact higher than the costs of any
7 ILEC.³¹ One could list a dozen reasons that water should carry a higher price than
8 diamonds—water is necessary for life and diamonds are not; water is consumed by every
9 person every day, diamonds are not; water has a large variety of uses, diamonds have
10 limited uses, and so forth. While all of these observations are true, they do not add up to
11 a proof that water will (or should) in fact carry a higher price than diamonds. Indeed,
12 they leave out a critical element that would tend to weigh in the other direction; in this
13 case, that diamonds are far more scarce than is water. It turns out that in the marketplace,
14 the scarcity factor outweighs all the others and water is far cheaper per ounce than are

³⁰ Denney Direct Testimony, pp. 26-30.

³¹ In fact, as a purely economic matter, even if CLECs' costs were higher than those of the ILEC, a competitive market would not permit CLECs to charge a higher price than that of the ILEC. Competitive markets do not permit entrants to charge higher prices than those of incumbents simply because (or if) the entrants happen to have higher costs. Such prices would not be viable in a competitive market because for a comparable product, consumers who have a choice would not choose to purchase from a higher-priced provider when they could choose a lower priced one instead. As a general matter, in any industry, entrants who must charge a higher (quality adjusted) price than that of the incumbent in order to cover costs would not survive in a competitive market because customers would not pay the higher price. To compete effectively against an incumbent, competitors with costs that are comparable to the incumbent's must offer at least as good a product; and those with only a comparable product must have comparable or lower costs. Investors in competitors who are working their way through the learning curve or building up scale economies must be willing and able to finance their early years of potential competitive losses while pricing at or below the incumbents' prices. Alternatively,

1 diamonds. Similarly, Mr. Denney's list of factors that would make CLECs' costs higher
2 than ILECs' costs excludes, for example, the countervailing facts that CLECs are not
3 burdened with legacy technologies and legacy network architectures, and that CLECs can
4 choose the specific geographic areas in which to build and serve, can serve other areas
5 without building a network (via resale, for example), or can choose not to serve some
6 areas at all. Whether any CLEC's costs are actually higher than any ILEC's costs, or vice
7 versa, is an empirical question that cannot be demonstrated by listing some factors that
8 would tend to weigh in one direction; rather, it would have to be demonstrated by actually
9 measuring costs.³²

10 **Q: MR. DENNEY ARGUES THAT CLECS HAVE A DIFFERENT NETWORK**
11 **ARCHITECTURE AND GENERATE "MORE TRAFFIC SENSITIVE COSTS TO**
12 **RECOVER VIA THEIR SWITCHED ACCESS RATES COMPARED TO**
13 **ILECS."**³³ **DOES THE FACT THAT CLECS CHOSE A DIFFERENT NETWORK**
14 **ARCHITECTURE FROM ILECS IMPLY THAT CLECS' COSTS ARE**
15 **HIGHER?**

16 **A:** No. CLECs configured their networks differently from ILECs presumably because the
17 chosen architecture is more efficient, not less efficient, than the ILECs' architecture,
18 given the scale and location of each CLEC's footprint. That more efficient architecture

competitors with higher costs, as the Joint CLECs purport to have, would have to justify higher retail prices with a better retail product or service.

³² In fact, in some states CLECs are permitted to demonstrate that their costs are higher than the ILECs' costs of providing switched access in order to exceed the ILEC's intrastate access rates. AT&T asked in discovery whether the Joint CLECs have ever made a cost showing that permitted them to charge access rates based on

1 might involve tradeoffs between the costs of different components of the network. As an
2 analogy, a car owner may choose to purchase more expensive tires if the better tires are
3 expected to improve gas mileage by enough to outweigh the additional costs of the tires.
4 The fact that this car owner purchased more expensive tires does not mean that the cost of
5 driving her car is higher than those of her neighbor who spent less on tires—rather, a
6 comparison would require a full analysis of what kind of car her neighbor owns, what
7 grade of gasoline it takes, and numerous other factors. Similarly, whatever the tradeoffs
8 faced by the CLECs between traffic sensitive and non traffic sensitive elements of their
9 network configurations, each CLEC rationally would have chosen its network
10 configuration because any other one, including that of the ILECs, would have resulted in
11 higher costs overall for that CLEC given its geographic footprint and customer
12 characteristics.

13 **Q: IS IT “CONFISCATORY” OR “HARMFUL [TO] LOCAL COMPETITION” TO**
14 **REGULATE CLECS’ SWITCHED ACCESS RATES, AS MR. DENNEY**
15 **CLAIMS?³⁴**

16 **A:** No. Where markets are competitive, the market is far better at picking winners and
17 losers, allocating resources, and setting prices, than is regulation. CLECs face significant
18 competition for retail local exchange services in Arizona, and it is appropriate to impose

their costs. In their responses, the Joint CLECs did not identify any such instances. See Joint CLECs’
Responses to AT&T Discovery Request No. ATT 1-12.

³³ *Denney Direct Testimony*, pp. 29-30.

1 minimal restrictions on CLECs' retail prices. These competitive forces do not translate to
2 effective competition for switched access services in light of the other regulatory
3 constraints and institutional facts of the market, however, and therefore it is consistent
4 with sound, welfare-enhancing public policy principles to constrain the CLECs' market
5 power over access services using rate caps on intrastate access prices. Doing so is not
6 confiscatory and would advance, not harm, competition.

7 **Q: MR. DENNEY ARGUES THAT RBOCS' INTERSTATE RATES ARE NOT AN**
8 **APPROPRIATE TARGET FOR CLEC RATES BECAUSE CURRENT**
9 **INTERSTATE RATES WERE SET WITHOUT CLEC INPUT.³⁵ IS THAT**
10 **TRUE?**

11 **A: No. Qwest's current interstate access rates were set in the CALLS proceeding in 2000, as**
12 **I explained in my Direct Testimony. While CLECs were not part of the negotiations that**
13 **led to Qwest's rates, CLECs did participate in the proceeding that led to the adoption of**
14 **the rates that were negotiated, and they *supported the rates that were ultimately set.***
15 **Specifically, the Association for Local Telecommunications Services ("ALTS"), a**
16 **coalition of CLECs, and another Joint CLEC member, tw telecom (then, Time Warner**
17 **Telecom), proposed reducing ILECs' interstate access rates to the same target rates as the**
18 **rates proposed by CALLS consortium, just more slowly.³⁶ Joint CLEC members XO,**

³⁴ Denney Direct Testimony, pp. 33-35.

³⁵ Denney Direct Testimony, p. 30.

³⁶ Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report And Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, *In the Matter of Access Charge Reform and Price Cap*

1 PAETEC, and tw telecom were ALTS members at the time ALTS filed its comments,³⁷
2 and tw telecom (Time Warner Telecom) additionally filed separate comments.

3 **Q: SHOULD THE COMMISSION BE CONCERNED THAT THE CURRENT ILEC**
4 **RATES SET IN THE CALLS PROCEEDING WERE "ARBITRARY" AND WITH**
5 **"NO SOLID COST FOUNDATION," AS MR. DENNEY SUGGESTS?**³⁸

6 **A:** No. First of all, the FCC did in fact consider cost studies in adopting the CALLS rates,
7 and it explained that one of the reasons it considered the CALLS rates to be just and
8 reasonable was that they were within the range of estimated economic costs of switched
9 access that were in cost studies presented to the Commission.³⁹ Second, AT&T does not
10 seek to lower intrastate rates all the way to ILECs' costs of providing switched access
11 service at this time, but rather to adopt a more modest reduction to interstate rates.

12 **Q: MR. DENNEY ARGUES THAT SWITCHED ACCESS RATES SHOULD**
13 **REFLECT COMPANY-SPECIFIC COSTS BECAUSE "IT IS STANDARD**
14 **PRACTICE TO SET REGULATED RATES FOR WHOLESALE SERVICES**

Performance Review for Local Exchange Carriers et al., Before the Federal Communications Commission, CC Docket Nos. 96-262 and 94-1 et al., FCC 00-193, (released May 31, 2000), (hereafter *FCC CALLS Order*), ¶ 178. See also, Joint Comments of the Association for Local Telecommunications Services and Time Warner Telecom, *In the Matter of Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers et al.*, Before the Federal Communications Commission, CC Docket Nos. 96-262 and 94-1 et al., April 3, 2000, p. 18 and Exhibit; and Joint Reply Comments of the Association for Local Telecommunications Services and Time Warner Telecom, *In the Matter of Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers et al.*, Before the Federal Communications Commission, CC Docket Nos. 96-262 and 94-1 et al., April 17, 2000, p. 7.

³⁷ See Joint CLECs' Responses to AT&T Data Request ATT 1-8. Integra states in its Discovery Response that it "does not believe that ELI was a member" of ALTS, but ALTS own list of members as of March 2000 indicates that Electric Lightwave was a member at the time. See "ALTS Network Members," at <http://web.archive.org/web/20000301204750/www.alts.org/frames/aboutalts.htm> (accessed January 27, 2010).

³⁸ *Denney Direct Testimony*, pp. 32-33.

³⁹ *FCC CALLS Order*, ¶ 176.

1 [SUCH AS UNBUNDLED NETWORK ELEMENTS] BASED ON COMPANY
2 SPECIFIC COSTS.”⁴⁰ IS IT “STANDARD PRACTICE” THAT REGULATED
3 RATES FOR WHOLESALE SERVICES PROVIDED BY CLECS BE SET AT
4 CLECS’ COSTS?

5 A: No. CLECs are not required to provide unbundled network elements and therefore there
6 is no “standard practice” by which CLECs’ prices for unbundled network elements would
7 be set. The only wholesale service for which I am aware that a “standard practice” exists
8 with respect to CLEC rates is interstate switched access. There the standing and
9 nationwide paradigm is the one ordered by the FCC in which CLECs’ interstate switched
10 access rates are capped by the interstate rates of the ILEC in its service territory.

11 **C. Joint CLECs’ Proposal to Benchmark CLECs’ Intrastate Access Rates at**
12 **Qwest’s 1999 Level Is Without Merit and Ignores the Joint CLECs’ Own**
13 **Disclosures to Their Shareholders**

14 Q: PLEASE COMMENT ON JOINT CLECS’ PROPOSAL TO USE QWEST’S 1999
15 INTRASTATE ACCESS RATES AS A “BENCHMARK” IF THE COMMISSION
16 DECIDES ON A TARGET OTHER THAN COST.⁴¹

17 A: This proposal has no logical or economic merit. Mr. Denney’s first argument is that the
18 rates in 1999 were the ones that “would have been considered” when CLECs decided to
19 enter the market. Whether this is true or not, however, and Mr. Denney provides no
20 evidence that it is, it does not justify Mr. Denney’s proposal. There was never any
21 implicit or explicit promise by regulators that access rates would remain unchanged, and

⁴⁰ Denney Direct Testimony, pp. 39-40.

1 any CLEC that entered the market on the basis of a business plan that required the CLEC
2 to receive a perpetual, never-changing monopoly revenue stream from access rates is not
3 a CLEC that regulators should seek to protect. It is not the job of regulators to protect
4 business plans that are founded on the exploitation of regulatory protections for
5 monopoly services, rather than on superior efficiencies and superior services. Moreover,
6 any CLEC that entered the market believing that intrastate access rates would not change
7 would have been irrational, given that access rates were changing in the interstate arena.⁴²
8 If CLECs were somehow deluded into thinking that their access rates would never be
9 regulated or decreased (and they were not, as I demonstrate shortly), they certainly should
10 have been disabused of that notion by 2001, when CLECs' access rates were capped in
11 the interstate arena, and in subsequent years as CLECs' intrastate rates were in fact
12 decreased in numerous other states, as I have already documented. In fact, for the Joint
13 CLECs themselves, their intrastate rates are lower than Qwest's current Arizona intrastate
14 rates in other nearby states, including New Mexico and Texas, as documented above in
15 Figure 1.⁴³

16 **Q: ACCORDING TO MR. DENNEY, A REDUCTION IN INTRASTATE ACCESS**
17 **RATES WILL FORCE CLECS TO CHANGE THEIR BUSINESS PLANS,**

⁴¹ *Denney Direct Testimony*, p. 49.

⁴² See, for example, McLeodUSA Incorporated, Form 10-K, for the fiscal year ended December 31, 1997, p. 23; and Time Warner Telecom Inc. Form 10-K, for the fiscal year ended December 31, 1999, pp. 20-21.

⁴³ The sum of Qwest's current intrastate local switching and CCL charge is 1.63¢ in Arizona. See Qwest Corporation Access Service Price Cap Tariff, §§ 3.8, 6.8.2.

1 **WHICH HAVE BEEN IMPLEMENTED “OVER THE PAST TEN PLUS**
2 **YEARS.”⁴⁴ IS THIS PLAUSIBLE?**

3 A: No. Any CLEC that has not accounted in its business plan for the possibility of
4 reductions in access rates can only be considered irresponsible to its shareholders.
5 CLECs not only should have known but demonstratively have known for at least the last
6 13 years that access rates are subject to reduction, and should have incorporated this in
7 their business plans well before now. Publically traded companies in the US are required
8 by securities regulations to advise their shareholders of all material risks to the business,
9 and they typically provide their shareholders with a long list of possible risks that could
10 befall their business in their annual 10-K filings with the SEC. The SEC disclosures
11 made by the Joint CLECs since 1997 make clear that all of the joint CLECs have been
12 well aware of the exposure of access rates to regulatory reductions since at least that time,
13 and have put investors on notice of possible reductions in switched access rates in both
14 the interstate and the intrastate jurisdictions throughout the last decade. Table 1, which is
15 attached as Exhibit DJA-R2, is a sample of such statements from the companies' 10-Ks.

16 In some instances, CLECs have warned their investors that the effect of changes in access
17 rates is unknown. CLECs have stated in other instances that they do not expect the effect
18 to be material; that it may also benefit the CLEC's business through lower access

⁴⁴ *Denney Direct Testimony*, p. 5. Mr. Garrett similarly urges the Commission to delay reform efforts, in order to

1 expenses; or that business plans reflect a downward trend in access rates. In all cases, the
2 CLECs have indicated that they have considered the effects of potential reductions to
3 access rates and have incorporated that risk into their business judgment and analysis.

4 While the CLECs properly and repeatedly notified their shareholders that they faced
5 possible access rate reductions and that the effect on their businesses was uncertain (the
6 standard language associated with such disclosures), the CLECs have not provided any
7 evidence in this proceeding (or anywhere else to my knowledge) that they actually have
8 left any state in which interstate or intrastate access rates were in fact reduced over the
9 last decade. When asked in discovery to provide support for the contention that a policy
10 to cap CLECs' access rates has curtailed their ability to compete or expand their network,
11 Mr. Denney admitted that he had not performed any analyses to arrive at this conclusion,
12 and the CLECs provided no evidence or examples that they have curtailed any activities
13 (let alone exited a state) as a result of access rates caps in any state.⁴⁵

14 Hence, the Joint CLECs' suggestion that they are entitled to Qwest's 1999 intrastate
15 access rates is simply without merit and inconsistent with the reasonable duty of any
16 public company to its shareholders to have conducted its business over the last decade to

⁴⁵ "ensure that business models can evolve." See, *Garrett Direct Testimony*, p. 8. The same response applies.
See Joint CLECs' Responses to AT&T Data Request ATT 1-9.b through 1-9.e.

1 best manage, anticipate, and respond as the business environment and business risks
2 change and evolve.

3 **Q: WHAT IS MR. DENNEY'S OTHER ARGUMENT IN SUPPORT OF HIS**
4 **PROPOSAL THAT CLECS' INTRASTATE ACCESS RATES BE CAPPED, IF**
5 **NOT AT "COST," AT QWEST'S 1999 INTRASTATE RATES?**

6 **A:** Mr. Denney argues that the decreases in Qwest's intrastate rates were the result of
7 revenue neutral settlement agreements entered into by Qwest, and there is no justification
8 to apply those decreases to CLECs.⁴⁶

9 **Q: IS THAT A VALID ARGUMENT?**

10 **A:** No, absolutely not. First, the "revenue neutral" decreases in Qwest's intrastate access
11 rates were offset by increases in retail prices⁴⁷ that had artificially been held below cost.⁴⁸
12 To the extent that CLECs compete with the ILECs, their retail prices compete with the
13 ILECs' retail prices, and an increase in the permitted retail rate that an ILEC can charge
14 creates more competitive opportunities for CLECs as well. Hence, an increase in the
15 retail price cap for the ILEC creates the opportunity for CLECs to increase prices as well,
16 or to win more customers from the ILECs by maintaining their prices at current levels, or
17 adopting an intermediate strategy between the two.

⁴⁶ Denney Direct Testimony, p. 49.

⁴⁷ Opinion and Order, *In the Matter of Qwest Corporation's Filing of Renewed Price Regulation Plan and In the Matter of the Investigation of the Cost of Telecommunications Access*, Before the Arizona Corporation Commission, Docket Nos. T-01051B-03-0454 and T-00000D-00-0672, March 23, 2006, p. 7.

1 Second, for reasons that I have discussed above and in my Direct Testimony, and as the
2 FCC has explained as well, as an economic matter CLECs' access rates should be no
3 greater than those of the ILEC with which they compete. A competitive market would
4 not permit a competitor with an equivalent service to charge a price that is higher than
5 that of the incumbent, regardless of the competitor's costs.

6 **D. The Cost of the Loop Is Not a Cost of Switched Access nor Properly**
7 **Included in the Price of Switched Access**

8 **Q: MR. DENNEY ARGUES THAT LOOP COSTS SHOULD BE INCLUDED IN**
9 **SWITCHED ACCESS COSTS BECAUSE IXCS "BENEFIT FROM THE LOCAL**
10 **LOOP."⁴⁸ IS THIS A VALID ARGUMENT?**

11 **A:** No. If one were to estimate the costs of providing switched access it would be incorrect
12 to include costs of the local loop. When an IXC purchases switched access service, the
13 functionality provided is call origination or termination. The costs of providing those
14 functions do not include costs of the loop. The costs of the loop are independent of the
15 usage on the loop, and, most important, are *dedicated to a particular customer*.
16 Therefore, the economically efficient way to recover the costs of the loop is in the form of
17 a flat rate paid by the customer to whom the loop is dedicated. The fact that long distance

⁴⁸ Qwest's Response to Staff Data Request 1.24.c.

⁴⁹ Denney Direct Testimony, pp. 61-62. Dr. Johnson makes a similar argument. See Johnson Direct Testimony, pp. 16-17.

1 service "benefit[s] from the local loop" does not alter this result and provides no
2 justification for a subsidy imposed on long distance providers to support the loop.

3 Such an argument is essentially the same as arguing that, because long distance customers
4 require the use of a handset (paraphrasing Mr. Denney's logic) in order to place or receive
5 a long distance call, and such customers "benefit from the use of the handset," that long
6 distance companies should subsidize the customer's handset. Handset manufacturers
7 might argue that long distance companies require the use of the handset to provide their
8 service, so long distance companies should be required to pay a fee to the handset
9 manufacturer for every minute of long distance usage to help recover the costs of the
10 handset. Their argument would be that if long distance companies (and, for the same
11 reasons, local exchange companies) are not required to pay a fee to handset manufacturers
12 for every minute of a long distance or, respectively, local call made using that handset,
13 the service providers are getting a free ride—after all, the call cannot be made without the
14 use of the handset and the cost of the handset is a "shared" cost between local and long
15 distance service. The fallacy in this argument is the same one as the fallacy in the
16 CLECs' argument regarding the loop: the cost of *furnishing* a handset, like the cost of
17 furnishing a loop, is independent of the *usage* on the handset, and the handset is
18 *dedicated* to a particular household. The efficient recovery of the cost of the handset is
19 that the customer pay a flat (not usage-sensitive) price for it to the company that built the

1 handset, and use it for as much or as little service as she likes—however much she may
2 use local or long distance service. There would be no justification for requiring IXCs to
3 pay a per minute fee to Panasonic or Motorola for the recovery of handset costs based on
4 how much their customers use the handset for long distance service. The same principles
5 hold for recovery of the costs of furnishing the loop.

6 **Q: DO ECONOMISTS AGREE WITH YOU THAT LOOP COSTS ARE NOT**
7 **ATTRIBUTABLE TO SWITCHED ACCESS SERVICE?**

8 **A:** Yes. The debate over this issue was effectively put to bed well over a decade ago by
9 renowned regulatory economist Alfred Kahn and co-author William Shew:

10 Using the price of telephone calls to recover access costs that do not in fact
11 vary as more or fewer calls are made... induces wasteful choices by
12 customers. It encourages them to order underpriced access lines that they
13 value less than the incremental costs to society of providing the lines, and
14 it discourages them from making overpriced calls whose value to them
15 would have exceeded the incremental cost to society. The same result
16 would follow if an electric utility were to supply its customers with all the
17 appliances they wanted at no charge and recovered the costs in the price of
18 electricity -- wasteful overpurchasing of appliances and underconsumption
19 of electricity.⁵⁰

20

⁵⁰ Alfred E. Kahn and William B. Shew, "Current Issues in Telecommunications Regulation: Pricing," *Yale Journal on Regulation* 4 (Spring 1987), p. 202. (Footnotes omitted.) See also, David L. Kaserman and John W. Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing," *Yale Journal on Regulation* 11 (Winter 1994), p. 125; ("Efficient (and intelligent) telephone pricing therefore requires a two part tariff. A fixed monthly charge, independent of usage, should recover the fixed costs of providing customer access to the network. A usage based charge for both local and long-distance services equal to the marginal costs of the respective services would recover usage sensitive costs.")

1 **Q: DOES THE FCC AGREE WITH YOU THAT LOOP COSTS ARE NOT**
2 **ATTRIBUTABLE TO SWITCHED ACCESS SERVICE?**

3 **A:** Yes, the FCC long ago rejected the argument posited by Mr. Denney. As early as 1982,
4 the FCC established the goal of recovering non-traffic-sensitive loop costs through flat
5 rates to end-users:

6 A subscriber who obtains a line to a local dial switch or a manual
7 switchboard necessarily obtains access to interstate as well as local
8 services. The cost of that access has traditionally been described as non-
9 traffic sensitive because such costs do not vary with usage. A subscriber
10 who does not use the subscriber line to place or receive calls imposes the
11 same NTS costs as a subscriber who does use the line. A subscriber who
12 does not make local calls would normally pay a flat fee for the exchange
13 portion of such costs. Imposing a flat charge for the interstate portion of
14 those costs is equally reasonable. Any other procedure violates the general
15 principle that costs should be recovered from the cost-causative ratepayer
16 whenever it is possible to do so.⁵¹

17 **E. Mr. Denney's Appeal to Ad Hominem Assertions of "Hypocrisy" and**
18 **"Insincerity" Are Incorrect and Reflect a Misunderstanding of the Economics**
19 **of the Situation**

⁵¹ Third Report and Order, *In the Matter of MTS and WATS Market Structure*, Before the Federal Communications Commission, FCC 82-579, (released February 28, 1983), ¶ 121.

1 Q: MR. DENNEY OPINES THAT THE IXCS' CALLS TO REDUCE ACCESS
2 RATES IN ARIZONA ARE "HYPOCRITICAL AND SELF-SERVING,"
3 CLAIMING THAT "OF COURSE, AT&T IS NOT WILLING TO FORGO ITS
4 SWITCHED ACCESS REVENUE."⁵² IS THAT TRUE?

5 A: No. AT&T is proposing rate reductions for all LECs, including the rates AT&T itself
6 charges as a CLEC in Arizona. The Joint CLECs, in contrast, are asking the Commission
7 to leave their own rates unchanged while reducing the rates of other LECs.

8 Q: MR. DENNEY ATTACKS THE "SINCERITY" OF AT&T'S PROPOSAL ON
9 THE GROUNDS THAT, ACCORDING TO MR. DENNEY, IF AT&T REALLY
10 THOUGHT INTRASTATE RATES WERE TOO HIGH, IT COULD HAVE
11 UNILATERALLY REDUCED ITS INTRASTATE RATES TO THE LEVEL IT IS
12 ADVOCATING IN THIS PROCEEDING.⁵³ IS THAT A VALID ARGUMENT?

13 A: No. Mr. Denney's facile argument fails to comprehend the economics of the situation.
14 Like all LECs, including each of the Joint CLECs, AT&T as a CLEC has market power
15 over switched access to its customers. If other LECs with whom AT&T competes are
16 allowed to price switched access at above-cost prices, it would be irresponsible to its
17 shareholders for AT&T to forgo the same opportunity. From AT&T's perspective,
18 reducing its own access rates when its competitors were permitted to fully exploit their
19 market power with higher prices would only leave money on the table, while generating
20 no additional demand (because, again, switched access service is a monopoly service and
21 retail long-distance prices reflect average, not individual, access rates). Moreover, not

⁵² Denney Direct Testimony, pp. 40-41.

1 only would it not be in AT&T's interest to unilaterally reduce its intrastate access rates, it
2 would not create meaningful social welfare benefits for AT&T to unilaterally reduce the
3 intrastate access rates it charges in Arizona. This is because if AT&T *were* the only
4 CLEC to decrease its access rates, there would be minimal effect on IXCs' long distance
5 prices because IXCs must average their prices rather than respond to the access rates of
6 individual LECs, as I explained earlier. One CLEC alone reducing its access rates would
7 have minimal effect on the average rate paid by IXCs. Hence, it would be neither in
8 AT&T's interests, nor meaningfully benefit consumers, for AT&T to unilaterally (i.e., on
9 its own, without similar action by the other LECs) reduce its access rates.

10 This is why regulatory intervention is necessary. In a competitive market it would be in a
11 company's own interests to reduce its price toward cost because it could benefit from the
12 increased demand it could thereby draw away from its competitors. In the provision of
13 switched access, the competitive mechanism is not functional and LECs, including the
14 Joint CLECs and AT&T, cannot be expected to voluntarily reduce their switched access
15 rates. By imposing the regulatory requirement that *all* LECs must reduce access rates,
16 however, there would be a meaningful reduction in the average access rate paid by IXCs,
17 and one would therefore expect retail long distance prices to fall, as I demonstrated in my
18 Direct Testimony. Customers would benefit; the requirement would be competitively

⁵³ *Denney Direct Testimony*, p. 42.

1 neutral as between LECs; and IXCs would be able to compete with other technologies on
2 a more level playing field.

3 **Q: MR. DENNEY ALLEGES THAT QWEST ARIZONA CHARGES RATES FOR**
4 **INTERSTATE AND INTRASTATE SPECIAL ACCESS THAT SIGNIFICANTLY**
5 **EXCEED COSTS, AS DOES AT&T ILLINOIS FOR INTERSTATE SPECIAL**
6 **ACCESS.⁵⁴ PLEASE COMMENT.**

7 **A:** Whether or not there is any merit to his assertions (which I have not analyzed), they have
8 no relevance to whether good public policy dictates reducing rates for ILECs' and
9 CLECs' intrastate switched access services in Arizona. The scope of this case does not
10 include special access prices. The Commission's jurisdiction does not even cover
11 *interstate* special access, and it certainly does not cover interstate special access *in*
12 *Illinois*. Whether Qwest or any other ILEC earns "significant revenues" on intrastate
13 special access in Arizona does not affect the benefits to consumers of reducing ILECs and
14 CLECs intrastate switched access rates. Mr. Denney's discussion of special access rates
15 is merely a distraction.

16 **F. Intrastate Access Reform Should Not Be Delayed Any Longer**

17 **Q: MR. DENNEY URGES THE COMMISSION TO DELAY OR REFRAIN**
18 **ENTIRELY FROM ANY REFORM THAT WOULD AFFECT THE JOINT**
19 **CLECS, BECAUSE THE ISSUES ARE "COMPLICATED" AND EACH**
20 **CARRIER HAS "ITS OWN CUSTOMER AND BUSINESS INTEREST." HE**

⁵⁴ Denney Direct Testimony, pp. 44-47.

1 **PROPOSES THAT THE COMMISSION “[DEAL] FIRST” ONLY WITH**
2 **“AREAS OF CONSENSUS.”⁵⁵ PLEASE COMMENT.**

3 A: Contrary to Mr. Denney’s urging, the Commission certainly understands that it is not its
4 job to rubber stamp the “areas of consensus” between some parties in a proceeding, or to
5 acquiesce to each carrier’s “business interest,” but rather to act in the interest of
6 consumers. Consumers would be best served in this proceeding by requiring all wireline
7 local exchange carriers to decrease their rates for intrastate access to their interstate
8 levels. Whatever the “complexity” of the issues for future, additional federal access
9 reform, requiring the reduction of CLEC and ILEC access rates is a measure that the FCC
10 *has already taken* after extensive analysis and the levels to which CLECs and ILECs
11 would reduce their intrastate rates under AT&T’s proposal are rates that the carriers,
12 including the CLECs, *are already charging for the same functionality in the interstate*
13 *jurisdiction.*

⁵⁵ *Denney Direct Testimony*, p. 16.

1 Q: MR. DENNEY CITES TO A RECENT FCC PUBLIC NOTICE IN SUPPORT OF
2 HIS RECOMMENDATION THAT THE COMMISSION WAIT FOR A RULING
3 BY THE FCC ON INTERCARRIER COMPENSATION RATHER THAN ACT
4 NOW.⁵⁶ DO YOU AGREE THAT REFORM AT THE STATE LEVEL SHOULD
5 BE DELAYED?

6 A: No. First, despite Mr. Denney's assertion that the FCC "really [does] plan to address
7 intercarrier compensation,"⁵⁷ he makes no attempt, nor can he, to predict *when* that might
8 actually happen. The recent FCC public notice to which he points is another in a line of
9 public notices and notices of proposed rulemaking in the last eight years in which the
10 FCC has sought input on intercarrier compensation reform. For example,

- 11 • Notice of Proposed Rulemaking in CC Docket No. 01-92, released April 27,
12 2001 (seeking comment on the feasibility of a bill-and-keep approach for a
13 unified intercarrier compensation regime and seeking alternative comment on
14 modifications to existing intercarrier compensation regimes)
- 15 • Public Notice in CC Docket No. 01-92, released October 18, 2002 (seeking
16 comment on two petitions that request rulings regarding the intercarrier
17 compensation regime applicable to certain types of wireless traffic)
- 18 • Further Notice of Proposed Rulemaking in CC Docket No. 01-92, released
19 March 3, 2005 (continuing the ongoing re-examination of intercarrier
20 compensation and seeking comments on specific proposals developed by a
21 number of industry groups)
- 22 • Public Notice in CC Docket No. 01-92, released July 25, 2006 (seeking
23 comment on the "Missoula Plan," filed by the National Association of
24 Regulatory Utility Commissioners' Task Force on Intercarrier Compensation)
- 25 • Public Notice in CC Docket No. 01-92, released November 8, 2006 (seeking
26 comment on a proposed interim process to address "phantom traffic")

⁵⁶ Denney Direct Testimony, p. 15.

⁵⁷ Denney Direct Testimony, p. 15.

- Public Notice in CC Docket No. 01-92, released February 16, 2007 (seeking comment on amendments to the Missoula Plan that incorporate a proposal addressing issues faced by “early adopter” states)
- Further Notice of Proposed Rulemaking in CC Docket No. 01-92, et al., released November 5, 2008 (seeking comment on certain intercarrier compensation and universal service issues, including three specific proposals) and Public Notice issued on November 12, 2008 establishing the comment dates for the three proposals contained in the NPRM

In fact, the public notice to which Mr. Denney referred is not even part of the long-standing intercarrier compensation docket (CC Docket 01-92) but part of another docket addressing the broadband plan.⁵⁸ There has been no public filing from the FCC regarding its intercarrier compensation docket since the November 2008 filings, which were issued under the previous administration. Hence, there is no basis for concluding that the FCC is going to act in any predictable time frame, and certainly there is no reason for the Commission to delay necessary and long-overdue reform in Arizona that merely catches up to decisions the FCC made nearly a decade ago.

Q: MR. DENNEY PROPOSES THAT ACCESS RATE REDUCTIONS BE IMPLEMENTED GRADUALLY, OVER AT LEAST EIGHT TO TEN YEARS.⁵⁹ WHAT IS THE BASIS FOR THIS APPEAL?

A: Mr. Denney offers a number of reasons:

1. CLECs are small and cannot absorb financial losses as easily as Qwest.⁶⁰

⁵⁸ *Denney Direct Testimony*, p. 15, footnote 19.

⁵⁹ *Denney Direct Testimony*, pp. 51-52. Mr. Denney proposes an initial phase of three years with no access charges reductions, and a subsequent period of phased-in reductions of five to seven years.

- 1 2. A gradual reduction would minimize the impact on end users.⁶¹
- 2 3. The FCC's CLEC interstate caps were implemented in three years, and the
- 3 FCC's most recent NPRM proposes a ten-year transition.⁶²
- 4 4. CLECs serve primarily business customers and have term contracts with
- 5 almost all of them, with an average term of 4.2 years, and would not be able to
- 6 modify retail rates for term customers.⁶³
- 7 5. Many LECs buy wholesale services from AT&T and Verizon that may contain
- 8 term commitments, and since IXC's have not committed to flow through
- 9 access charge reductions, immediate implementation could "result in a
- 10 windfall" for IXC's.⁶⁴
- 11 6. CLECs are more vulnerable to mandatory reductions because business
- 12 customers generate higher calling volumes than residential customers.⁶⁵

13 **Q: DO YOU CONSIDER ANY OF THESE ARGUMENTS TO BE PERSUASIVE?**

14 **A:** No. I have considered each and have not found any to have merit, and I will respond to
15 each in turn. I note first, however, that aside from the defects in his arguments, Mr.
16 Denney completely ignores the fact that the CLECs have been exempt from access reform
17 in Arizona for the last eight years during which the main ILEC has been subject to access
18 rate reductions. Therefore, while Qwest's excessive access rates demand further reform
19 now, CLEC reform is even more overdue and does not merit additional delays and
20 avoidance.

⁶⁰ Denney Direct Testimony, pp. 50-51.

⁶¹ Denney Direct Testimony, p. 51.

⁶² Denney Direct Testimony, p. 51.

⁶³ Denney Direct Testimony, p. 52.

⁶⁴ Denney Direct Testimony, p. 53.

⁶⁵ Denney Direct Testimony, p. 53.

1 **Q: PLEASE EXPLAIN THE DEFECTS IN MR. DENNEY'S ARGUMENT THAT**
2 **CLECS ARE SMALL AND CANNOT ABSORB FINANCIAL LOSSES AS**
3 **EASILY AS QWEST CAN.**

4 **A:** First, the proposed access reform amounts to replacing a monopoly revenue stream from
5 IXCs with the opportunity to earn revenue in the competitive market. To the extent that
6 CLECs compete with the ILECs, their retail prices compete with the ILECs' retail prices,
7 and an increase in the permitted retail rate that an ILEC can charge creates more
8 competitive opportunities for CLECs as well, as I explained earlier. Hence, there is no
9 necessary "financial loss" associated with the proposed access reform unless the CLECs
10 are not able to compete effectively in the retail market. The necessity of all LECs to
11 compete effectively in the retail market is a social benefit of access reform, not a defect.

12 Second, Mr. Denney seems to think it is relevant that the CLECs' global revenues are
13 relatively small in comparison to the ILECs' global revenues (and AT&T's global
14 revenues),⁶⁶ but fails to note that the CLECs' global revenues are actually extremely large
15 in comparison to a more relevant statistic: the amount of access revenues potentially at
16 stake for them in this proceeding. In fact, to the extent that "financial loss" is relevant at
17 all, the more relevant fact than the comparisons offered by Mr. Denney is that for each of
18 the Joint CLECs, the reduction in their access revenues under AT&T's proposal would be
19 far less than half a percent of their total revenues, and on average would be *less than one*

1 *tenth of one percent* of their total revenues.⁶⁷ And that is before one even considers the
2 CLECs' opportunities to recover at least some of those access reductions through
3 rebalancing local rates or other business measures.

4 **Q: WOULD IT "MINIMIZE THE IMPACT" TO END USERS TO ALLOW AN**
5 **EIGHT TO TEN YEAR TRANSITION PERIOD FOR ACCESS RATE**
6 **REDUCTIONS, AS MR. DENNEY CLAIMS?**⁶⁸

7 **A:** Yes, in the sense that it would minimize the *benefits* that consumers would otherwise
8 enjoy as a result of access reform. It would also perpetuate the already-excessive amount
9 of time that the uneconomically high intrastate access rates in Arizona have distorted
10 competition across long distance technologies. Finally, it would extend the already-
11 excessive amount of time that CLECs in Arizona have had to charge inflated intrastate
12 access rates rather than be required to earn those revenues in the competitive retail
13 marketplace. Consumers have paid unnecessarily high rates for intrastate long distance
14 service in Arizona for the last ten years as a result of intrastate access rates that exceed
15 interstate access rates. CLECs have been granted a reprieve during that time because only
16 Qwest was required to make any access rate reductions. While a sound access reform

⁶⁶ Denney Direct Testimony, Table 3.

⁶⁷ For Integra, it would be 0.23 percent of its total 2008 revenues; for PAETEC, it would be 0.02 percent; for tw telecom, 0.16 percent; for XO Communications, 0.04 percent; and for all Joint CLECs taken together the loss would be 0.09 percent of their total 2008 revenues. The figures for PAETEC, XO Communications, and Integra are based on the average rates provided by the CLECs in response to Staff's Data Request STF 1.1, which are subject to revision, as I explained above.

⁶⁸ Denney Direct Testimony, pp. 9, 51.

1 policy would permit ILECs (and potentially, therefore, CLECs) to increase retail prices
2 for local service to balance the access revenue reductions, the net effect would be positive
3 and beneficial for consumers for all the reasons that I articulated in my Direct Testimony.

4 **Q: DIDN'T THE FCC PROVIDE FOR A GRADUAL DECLINE IN CLECS'**
5 **INTERSTATE ACCESS RATES RATHER THAN DROP THE CLEC RATE**
6 **IMMEDIATELY IN THE CLEC ACCESS REFORM ORDER?**

7 **A:** Yes, the FCC gave CLECs up to three years to reduce their interstate rates to those of the
8 ILEC with whom they compete,⁶⁹ far *less* than the eight to ten years that the Joint CLECs
9 are requesting here, for reductions on a far *greater* proportion of their access revenues
10 than are at issue today. CLECs sell many times more interstate access minutes than
11 intrastate access minutes,⁷⁰ so a substantially greater share of their access revenues were
12 at stake when they underwent interstate access reductions resulting from the FCC's 2001
13 Order.

14 Today there is no reason for any gradual decline. In 2001, the FCC believed that it
15 needed to provide a transition period to allow CLECs to adjust their business plans
16 because they had not been "held to the regulatory standards imposed on ILECs."⁷¹
17 Today, however, CLECs have been subject to interstate rate caps at ILEC levels for eight
18 years; they are subject to intrastate rate caps in numerous states; they have been on notice

⁶⁹ CLEC Access Charge Reform Order, ¶ 52, and 47 CFR §§ 61.26 (b) and (c).

⁷⁰ See individual CLEC Responses to Staff Data Request STF 1.1.

1 at least since the FCC's *CLEC Access Reform Order* in 2001 that the regulatory
2 landscape was moving toward capping CLEC access rates; and they have been informing
3 their shareholders accordingly over these many years, as I demonstrated earlier. CLECs
4 have had ample time to adjust their business plans to this reality.

5 **Q: MR. DENNEY ARGUES THAT IF THERE ARE TO BE ANY ACCESS RATE**
6 **REDUCTIONS THEY SHOULD BE PHASED IN OVER "AT LEAST" FIVE TO**
7 **SEVEN YEARS, BECAUSE CLECS "TYPICALLY" HAVE LONG TERM**
8 **CONTRACTS WITH THEIR CUSTOMERS WITH TERMS THAT ARE**
9 **"OFTEN" FIXED DURING THE TERM OF THE AGREEMENT.⁷² IS THIS A**
10 **VALID REASON TO PHASE IN ACCESS RATE REDUCTIONS?**

11 **A:** No. First, I note that the Joint CLECs declined to provide these contracts in discovery, on
12 the grounds (among others) that they are not relevant to this proceeding.⁷³ If they are
13 irrelevant to this proceeding they cannot form the basis of the Joint CLECs' argument
14 that access reform should be delayed. The Joint CLECs' refusal to provide the contracts
15 precludes me from examining them and testing Mr. Denney's claim by determining to
16 what extent CLECs in fact "typically" have long term contracts and how common it is
17 that they "often" have fixed terms.

18 In any event, contracts with customers (at the wholesale or retail level) are common in
19 our economy across numerous industries. All companies that enter into contracts that last

⁷¹ *CLEC Access Charge Reform Order*, ¶¶ 61-62.

⁷² *Denney Direct Testimony*, pp. 51-52.

⁷³ Joint CLECs' Response to AT&T Data Request ATT 1-5.

1 a meaningful period of time do so recognizing both the benefits and risks of locking into
2 terms. The benefits to the seller include the certainty of the agreed-upon demand flow
3 and prices; the benefits to the buyer include the certainty of the price and of a committed
4 supplier. The risks to the buyer include the fact that market prices may fall, making the
5 contract a poor deal. The risks to the seller include the fact that input costs may rise,
6 reducing the profitability of the agreed-upon price. In some cases contracts include
7 language that allows the price, quantity, or other terms to be modified depending on
8 observed market events or other factors. In all cases, a rational firm entering a contract
9 will incorporate into the price to which it agrees some adjustment for the risks it is
10 assuming. For example, it would be rational to build in a risk premium to a price that is
11 locked in by contract over several years, to compensate the seller for the possibility that
12 input costs will rise during the contract term (and weighed against the possibility that
13 input costs will fall and profits will be higher than expected). The buyer would normally
14 be willing to pay some premium for being insulated from that pricing risk, and one would
15 expect the contracted price in a competitive market to reflect these risk considerations.

16 The risk to CLECs that access rates may fall is no different in economic terms than the
17 risks that companies in any industry face when they make long term contracts that their
18 input prices may rise, availability of inputs may fall, revenues from other services may
19 fall, the legal environment may change, and so forth. As I have discussed, CLECs

1 certainly were aware of the possibility of access rate reductions. If they did not build
2 terms into their contracts that explicitly permitted the price to change in the event of
3 access rate changes, they certainly had every opportunity to lock in contracted prices that
4 incorporated a premium for the risks they faced.

5 **Q: DO THE CLECS' ARGUMENTS SUPPORT THEIR DEMAND FOR A**
6 **TRANSITION PERIOD OF FIVE TO SEVEN YEARS, OR EVEN MORE?**

7 **A:** No. Even aside from the fact that CLECs have an obligation to their shareholders to lock
8 themselves into contracts with customers only to the extent they have agreed to prices that
9 reflect and manage their risks, the time period they demand is unconnected to the facts
10 they cite. Mr. Denney claims that McLeod has contracts with "virtually 100%" of its
11 customers, and that the average agreement term is 4.2 years.⁷⁴ He does not say what
12 percentage of these contracts have fixed pricing terms, only indicating that CLECs'
13 contracts "often" have fixed terms. Even if every single McLeod contract had fixed terms
14 (which presumably is not the case, or Mr. Denney would have said so), the average
15 agreement life of 4.2 years means that approximately 25 percent of McLeod's customers
16 roll off contract every year. In two years after an access rate change approximately half of
17 all customers who were under contract at the time of the change would have rolled off

⁷⁴ *Denney Direct Testimony*, p. 52.

1 their contracts,⁷⁵ and that does not account for new customers that McLeod would have
2 added after the change was made. It also does not account for the fact that some, many,
3 or perhaps most of the CLECs' contracts do permit pricing terms to change in response to
4 changes in the CLECs' costs, so the only customers with whom the CLECs are locked
5 into prices are those with whom the contract does not allow for pricing modifications in
6 relevant circumstances. In fact, this proceeding in Arizona has been preceded by two
7 years of workshops and industry discussion, so that most CLEC customers will have
8 already rolled off of any contracts they entered into before this process began in Arizona.
9 Hence, nothing in the figures provided by Mr. Denney supports his request for an
10 arbitrarily long transition period.

11 **Q: MR. DENNEY ARGUES THAT CLECS "COULD BE MORE VULNERABLE"**
12 **THAN ILECS TO ACCESS RATE REDUCTIONS BECAUSE BUSINESS**
13 **CUSTOMERS "CAN GENERATE HIGHER CALLING (AND ACCESS)**
14 **VOLUMES THAN RESIDENTIAL CUSTOMERS," AND CLECS FOCUS ON**
15 **BUSINESS CUSTOMERS MORE THAN DO ILECS.⁷⁶ DOES THIS**
16 **OBSERVATION HELP THE CLECS' CASE?**

17 **A: No. In fact, according to the CLECs' discovery responses, none of the Joint CLECs**
18 **serves residential customers.⁷⁷ They serve business customers only. Historically, as I**

⁷⁵ This assumes that the actual contract life of customers under contract is 4.2 years, with no variability. If there is variability in contract life with average over the different contracts being 4.2 years, one would expect *even more* to have rolled off in two years.

⁷⁶ Denney Direct Testimony, p. 53.

⁷⁷ See XO Response to AT&T Data Request AT&T 2.1; tw telecom Response to AT&T Data Request AT&T 2.1; Integra Responses to Staff Data Request STF 1.3 and to AT&T Data Request 2.6; and PAETEC Response to

1 discussed in my Direct Testimony, it was residential customers that required subsidies, in
2 order to keep retail residential rates acceptably low from a policy standpoint. Retail local
3 exchange prices to business customers have historically been a *source* of cross-subsidy,
4 not a recipient. That is, historically, business rates were set by regulators at above-cost
5 levels to cross-subsidize residential prices. The historical justification for excessive
6 access rates simply does not apply to CLECs because the public policy rationale was
7 never to subsidize retail business services. Hence, the admission that these CLECs serve
8 only business customers further exposes the fallacy of the Joint CLECs' arguments.
9 Their proposal protects the Joint CLECs and their business customers at the expense of
10 residential (and business) customers of IXCs.

11 **Q: MR. DENNEY FURTHER ASSERTS THAT IMMEDIATE REDUCTIONS IN**
12 **ACCESS RATES "COULD RESULT IN A WINDFALL" TO IXCS BECAUSE**
13 **SOME LECS PURCHASE WHOLESALE SERVICES FROM IXCS UNDER**
14 **TERM COMMITMENTS.⁷⁸ IS THIS A LEGITIMATE CONCERN?**

15 **A:** No. I have not been provided the opportunity to review any such contracts, but regardless
16 of their terms the evidence does not support Mr. Denney's assertion.⁷⁹ The regression
17 that I presented in my Direct Testimony showed that access reductions were reflected in

Staff Data Request STF 1.3. See also Joint CLECs' Response to AT&T Data Request ATT 1-17. PAETEC does not market to residential customers or offer service to new residential customers.

⁷⁸ Denney Direct Testimony, pp. 52-53.

⁷⁹ Joint CLECs were asked to provide all term commitment contracts with their wholesale long distance providers that are currently in effect, but they refused to do so. See Joint CLECs' response to AT&T's Data Request ATT 1-6.

1 lower retail prices *within one year* of the access charge reduction.⁸⁰ The data show that,
2 despite any term contracts into which CLECs may have entered in their operations around
3 the country, the market response to access rate reductions has in fact been retail rate
4 reductions.

5 In addition, as I have already noted, CLECs should have been and indeed were aware of
6 intrastate access charge proceedings which resulted in access charge reductions in other
7 states and of the risk of access charge reductions. These risks should have been
8 incorporated into the contract prices or conditions of the contract, either implicitly or
9 explicitly.

10 **G. Mr. Denney's Claims that IXC's Will Not Flow Through Access Rate**
11 **Reductions Are Not Supported by Any Facts and Are Contradicted by the**
12 **Data**

13 **Q: ACCORDING TO MR. DENNEY, IXCS WILL NOT NECESSARILY FLOW**
14 **THROUGH ACCESS COST REDUCTIONS TO ARIZONA CONSUMERS.⁸¹**
15 **PLEASE COMMENT.**

16 **A:** While the Joint CLECs offer speculation and unsupported assertions, I provided sound,
17 empirical evidence in my Direct Testimony based on the actual behavior of long distance
18 prices and access rates over a number of years and 50 states that IXCs do reduce long
19 distance prices when access prices are reduced. I also explained in my Direct Testimony

⁸⁰ See Aron Direct Testimony, pp. 60-65.

1 that even an unregulated monopolist would decrease its retail prices in response to a
2 decrease in its variable costs (as a reduction in access rates is), because it would be profit-
3 maximizing to do so.⁸² The expectation that decreased access rates would result in
4 decreased retail long distance prices is not reliant on any assumptions about how
5 competitive the long distance market is, or on any assumptions about any carriers' market
6 power or lack thereof. Regardless of the degree of competitiveness, the profit motive
7 drives companies to lower prices when variable costs fall.

8 **Q: MR. DENNEY ARGUES THAT THE IXCS HAVE MONOPSONY POWER WITH**
9 **RESPECT TO SWITCHED ACCESS SERVICE,⁸³ AND THEREFORE THEY**
10 **SHOULD NOT BE PERMITTED TO NEGOTIATE CONTRACT RATES FOR**
11 **SWITCHED ACCESS. DOES THE FCC AGREE WITH MR. DENNEY THAT**
12 **IXCS HAVE "MONOPSONY POWER"?**

13 **A:** No. The FCC explicitly rejected this argument in the *CLEC Access Charge Reform*
14 *Order*, concluding that the evidence did not support it. The FCC further concluded in
15 that Order that antitrust laws are available "to protect CLECs from the exploitation of any
16 monopsony power that IXCs may possess."⁸⁴

⁸¹ Denney Direct Testimony, p. 64.

⁸² Aron Direct Testimony, pp. 66-67.

⁸³ Denney Direct Testimony, pp. 55-57.

⁸⁴ CLEC Access Charge Reform Order, ¶ 85.

1 **III. Response to the Direct Testimony of Douglas Garrett on behalf of Cox Arizona**
2 **Telcom**

3 **Q: MR. GARRETT ASSERTS THAT "REDUCING ACCESS CHARGES WILL**
4 **ONLY EXACERBATE THE DILEMMA OF MAINTAINING A COMPETITIVE**
5 **NETWORK," BECAUSE "ACCESS LINES AND MINUTES OF USE ARE ON A**
6 **STEADY DOWNWARD TRACK."⁸⁵ WILL REDUCING ACCESS RATES**
7 **EXACERBATE THE PROBLEM OF MAINTAINING THE NETWORK?**

8 **A:** No. Mr. Garrett fails to recognize that even aside from the inefficiencies, competitive
9 distortions, and improperly placed burdens associated with the current regime of
10 supporting local exchange service with implicit subsidies from access rates, access rates
11 are simply no longer a reliable mechanism for subsidizing the local loop *because* of the
12 declines in access lines and minutes of use. As ALECA has made clear,⁸⁶ the declines in
13 access minutes are causing the traditional source of funding for the local network to dry
14 up and a more reliable and economically rational system of telecommunications pricing is
15 necessary.

⁸⁵ Garrett Direct Testimony, p. 4.

⁸⁶ "The Case for Arizona Access Charge Reform," Arizona Local Exchange Carrier Association White Paper, November 2, 2006, (hereafter 2006 ALECA White Paper), pp. 6-7.

1 Q: MR. GARRETT OF COX URGES THE COMMISSION TO DELAY ACCESS
2 REFORM BECAUSE "ONLY BY RATIONALIZING RATES UNDER A
3 NATIONAL FRAMEWORK CAN...ARBITRAGE BE CURTAILED OVER
4 TIME."⁸⁷ PLEASE COMMENT.

5 A: Mr. Garrett has it backwards. Reducing intrastate access rates in Arizona to interstate
6 rates, as AT&T proposes, is precisely what is necessary to reduce arbitrage, because
7 arbitrage opportunities are created by rates that are excessive relative to costs, and by
8 rates that are different from each other. AT&T's proposal will reduce both forms of
9 arbitrage. Doing nothing while waiting for the FCC to act will certainly not decrease
10 arbitrage opportunities in Arizona, particularly while other states are reducing arbitrage
11 opportunities in their states by reforming their own intrastate access rates. Moreover,
12 contrary to the assertion of Mr. Garrett, there is absolutely no reason that a national
13 framework is needed in order to reduce arbitrage opportunities in Arizona—reducing
14 intrastate rates to interstate levels in Arizona will reduce arbitrage opportunities in
15 Arizona.

16 Q: MR. GARRETT ASSERTS THAT "CHANGING RATES IN ONE
17 JURISDICTION WILL LIKELY HAVE NO EFFECT ON THE RATES
18 ARIZONA CONSUMERS PAY."⁸⁸ IS THIS TRUE?

19 A: No. Mr. Garrett's unsupported speculation is again belied by the data. The facts are, as I
20 explained in my Direct Testimony, that states that have lower intrastate access rates have

⁸⁷ Garrett Direct Testimony, p. 5.

1 lower retail intrastate long distance prices on average and states with higher average
2 intrastate access rates have higher intrastate long distance prices, on average.

3 **Q: MR. GARRETT FURTHER ASSERTS THAT ACCESS REFORM "CANNOT BE**
4 **SUCCESSFUL ON A STATE-BY-STATE BASIS" AND THEREFORE THE**
5 **COMMISSION MUST WAIT FOR A "NATIONAL FRAMEWORK."⁸⁹ PLEASE**
6 **COMMENT.**

7 **A:** I would suggest that consumers in states that have reduced intrastate access rates, and are
8 experiencing substantially lower prices on average for intrastate long distance service,
9 would prefer to have those benefits now rather than waiting for the possibility that the
10 FCC might someday institute a full, nationwide plan of access reform even though the
11 FCC's efforts have produced no results for years. While a nationwide, comprehensive
12 plan is desirable, the straightforward plan proposed by AT&T—which only reconciles
13 intrastate rates with the interstate rates that were established in the federal jurisdiction
14 nearly a decade ago and, by all signals, will be reduced much further in future federal
15 access reform plans—can give consumers substantial relief now, reduce distortions, cause
16 long distance prices to fall in Arizona, reduce arbitrage, increase efficiency, and enhance
17 competition.

⁸⁸ *Garrett Direct Testimony*, p. 5.

⁸⁹ *Garrett Direct Testimony*, p. 6.

1 IV. Response to the Direct Testimony of Douglas Duncan Meredith on Behalf of
2 ALECA

3 Q: PLEASE SUMMARIZE YOUR RESPONSE TO ALECA'S TESTIMONY.

4 A: ALECA correctly identifies the competitive and public policy distortions created by
5 currently excessive access rates, but its proposed solution is not adequate to address the
6 problems it identifies. ALECA proposes to reduce LECs' intrastate access rates to
7 Qwest's composite intrastate rate. But every problem that it identifies would be better
8 addressed by reducing intrastate access rates to interstate levels. Indeed, ALECA itself
9 asserted in its 2006 White Paper, "In order to provide immediate Arizona access rate
10 reform, the intrastate composite rate *needs to be at the level of the interstate composite*
11 *rate.*"⁹⁰

12 In addition, ALECA argues that there should be no increases to retail prices, and that
13 revenues forgone as a result of its proposed access reductions should be recovered
14 entirely through draws from an Arizona Universal Service Fund. However, recovering all
15 forgone access revenues from a universal service fund rather than at least partially
16 through increases in retail rates would perpetuate a subsidy system by which retail prices
17 are kept inefficiently low, merely broadening the source of subsidy from IXC's to all

⁹⁰ 2006 ALECA White Paper, p. 9. (Emphasis added.) See also ALECA Response to Staff's First Set of Data Requests, STF 1.10. ("The rural ILECs believe unifying the intrastate and interstate access rates and rate structures is the appropriate action to take.")

1 telecommunications customers who support the USF fund. While broadening the base of
2 support for the subsidy (by reducing intrastate access rates and recovering the forgone
3 revenues through USF draws) would reduce the competitive distortions associated with
4 the funding of the subsidy, and would therefore be an improvement over the current
5 system, recovering all forgone access revenues from a USF fund would unduly perpetuate
6 a variety of other inefficiencies and distortions. A superior solution would be to recover
7 part or all of the forgone access revenues by providing LECs the opportunity to increase
8 retail local exchange prices to a benchmark, as I explained in detail in my Direct
9 Testimony. ALECA has not attempted to demonstrate that some increase in retail prices
10 would make their services unaffordable, and therefore there is no reason to reject a
11 benchmark approach. Certainly, the vast differences in basic local rates across the
12 ALECA members suggests that at least some members could increase rates without any
13 adverse effect on telephone penetration.

14 **Q: WHAT ARE MR. MEREDITH'S ARGUMENTS FOR HIS RECOMMENDATION**
15 **TO REDUCE THE COMPOSITE INTRASTATE RATE OF EACH ALECA**
16 **MEMBER TO QWEST'S COMPOSITE INTRASTATE RATE?**

17 **A:** According to Mr. Meredith, reducing carriers' intrastate access rates to Qwest intrastate
18 rate would (i) "promote equity between urban/suburban and rural areas of the state;" (ii)
19 provide a simple and straightforward target rate, because Qwest's composite rate is

1 publicly available; and (iii) lessen the burden of the AUSF relative to the burden that
2 would be incurred if rates are reduced to interstate levels.⁹¹

3 **Q: DOES A REDUCTION OF ALECA MEMBERS' INTRASTATE RATES TO**
4 **QWEST'S INTRASTATE LEVELS BEST PROMOTE "EQUITY"?⁹²**

5 **A:** No. A policy under which all ILECs decrease their intrastate access rates to their own
6 interstate rates is more equitable *to consumers* because it would result in a greater overall
7 average reduction in intrastate access rates and would thereby reduce the competitive
8 inequity between wireline long distance and wireless carriers. It would also eliminate the
9 arbitrage opportunities associated with the differences between intrastate and interstate
10 rates by making those rates equal to each other for each carrier. It would impose the same
11 policy on all carriers, including Qwest, and conform that policy to the federal policy that
12 has been in place for many years.

13 **Q: DOES ALECA AGREE WITH YOU THAT INTRASTATE ACCESS CHARGES**
14 **MUST BE BROUGHT DOWN TO INTERSTATE LEVELS IN ORDER TO**
15 **REFLECT THE MODERN COMPETITIVE ENVIRONMENT?**

16 **A:** Yes. According to ALECA's white paper,

17 In response to the Montana Public Service Commission inquiry into
18 matters concerning intercarrier compensation, the Montana
19 Telecommunications Association stated: "the differences in intrastate
20 and interstate access charges can no longer be sustained in a

⁹¹ Meredith Direct Testimony, p. 7.

⁹² Meredith Direct Testimony, p. 7.

1 competitive environment, especially where technology has enabled
2 telephone calls to circumvent access charges altogether” and providing as
3 an example that “intra-MTA wireless traffic is subject to reciprocal
4 compensation and is responsible for significant reduction in local
5 exchange carrier intrastate access revenues” and that “VoIP traffic
6 currently avoids access payments altogether.” **ALECA agrees with this**
7 **observation** and believes that the pace of market changes necessitates
8 prompt action in Arizona. Without action over time there will be an
9 increased burden on end-user customers because end-user customers will
10 bear an increased cost burden, which left unchecked will likely raise
11 affordability issues in rural areas.⁹³

12 **Q: WOULD IT BE MORE “SIMPLE” OR “STRAIGHTFORWARD” FOR ALECA**
13 **MEMBERS TO USE QWEST’S INTRASTATE RATE AS A TARGET RATE**
14 **THAN THEIR OWN INTERSTATE RATES?**⁹⁴

15 **A:** No. I am aware of no reason that it would be simpler for an ALECA member to try to
16 mirror the composite intrastate rate of a different carrier operating in a different area than
17 to mirror its own interstate rates, which it has already tariffed and which it is already
18 charging. If anything, common sense suggests that it would be much easier to implement
19 the simple plan proposed by AT&T, because all LECs have already implemented that
20 same plan for interstate traffic.

⁹³ 2006 ALECA White Paper pp. 6-7. (Footnotes omitted, emphasis added.)

⁹⁴ Meredith Direct Testimony, p. 7.

1 **Q: ALECA OBSERVES THAT REDUCING SWITCHED ACCESS RATES WILL**
2 **REDUCE OR ELIMINATE THE INCENTIVE FOR ARBITRAGE.⁹⁵ PLEASE**
3 **COMMENT.**

4 **A:** The only way to eliminate the incentive for arbitrage between interstate and intrastate
5 access rates is to make them equal. Reducing ALECA carriers' (or CLECs') intrastate
6 rates to Qwest's intrastate rate would not eliminate this form of arbitrage and therefore
7 would not achieve one of the public policy goals of access reform. As ALECA correctly
8 observed in discovery:

9 Unifying or equalizing the rates for each jurisdiction [intrastate and
10 interstate] will remove the incentive for carriers to provide incomplete call
11 detail records or to seek routing alternatives that do not match the
12 originating jurisdiction of a call. Moving to Qwest's intrastate access rates
13 would not address rate arbitrage encouraged by an individual company's
14 variance between intrastate and interstate access rates.⁹⁶

15 **Q: ALECA ARGUES THAT ESTABLISHING A BENCHMARK FOR RETAIL**
16 **LOCAL EXCHANGE SERVICE PRICES IN ORDER TO ACHIEVE REVENUE**
17 **NEUTRALITY WOULD ONLY "ADD COMPLICATIONS," AND THAT ALL**
18 **LOST ACCESS REVENUE SHOULD BE FUNDED THROUGH A UNIVERSAL**
19 **SERVICE FUND.⁹⁷ PLEASE COMMENT ON THIS PROPOSAL.**

20 **A:** As I explained in my Direct Testimony, recovering any forgone access revenues through a
21 universal service fund perpetuates inefficient and distorted retail prices by, for example,
22 burdening urban consumers, including those with relatively low incomes, in order to

⁹⁵ *Meredith Direct Testimony*, p. 12.

⁹⁶ ALECA Response to Staff Discovery First Set of Data Requests, STF 1.10. See, also, *Meredith Direct Testimony*, p. 6.

1 subsidize rural customers, even those with relatively high incomes. Establishing a
2 benchmark involves conducting a pricing analysis of the type that is certainly within the
3 normal purview of a regulatory commission and consistent with its obligations and
4 expertise. The Commission would do a disservice to Arizona consumers if it were to
5 decline to establish a reasonable benchmark in this case—and instead impose all revenue
6 recovery on a state universal service fund—on the grounds that establishing a benchmark
7 would be “complicated.” Mr. Meredith surely underestimates the Commission’s
8 expertise by suggesting it.⁹⁸

9 **V. Response to the Direct Testimony of Lisa Hensley Eckert on Behalf of Qwest**

10 **Q: PLEASE DESCRIBE YOUR UNDERSTANDING OF QWEST’S THEORY OF**
11 **THIS CASE.**

12 **A:** I begin by observing that Qwest admits to several key points that validate the opinions I
13 reached in my Direct Testimony and that validate AT&T’s position in this case that
14 intrastate access rates should be reduced to interstate levels. Qwest admits that:

- 15 1. Access rates were historically established to include, and do today include,
16 significant subsidy elements.⁹⁹

⁹⁷ *Meredith Direct Testimony*, p. 8.

⁹⁸ In fact, the Commission’s Staff apparently does not consider establishing a benchmark to be unduly complicated, insofar as Staff proposes establishing one for each carrier rather than the simpler approach proposed by AT&T of a single statewide benchmark. See *Shand Direct Testimony*, Executive Summary, ¶ 6.

⁹⁹ *Eckert Direct Testimony*, p. 4. See also Qwest’s Response to Staff Data Request 1.24.

2. Excessive access rates distort competition and cause inefficiency.¹⁰⁰
3. Reducing excessive access rates will decrease fraud and regulatory arbitrage.¹⁰¹

In addition, Qwest agrees that:

4. Terminating switched access is a monopoly service whether provided by an ILEC or CLEC¹⁰² and
5. CLECs should not be permitted to charge switched access rates above an appropriate ILEC-determined benchmark.¹⁰³

Hence, Qwest does not dispute that excessive access rates cause inefficiency. Qwest specifically suggests that the Commission require other carriers to decrease their intrastate access fees (i.e., the fees that the Qwest long distance entity pays when its customers make intrastate calls to customers of other LECs in Arizona) to Qwest's intrastate rates.¹⁰⁴

Qwest objects, however, to a requirement to reduce its own intrastate rates, on the grounds that the Commission already addressed Qwest's rates in its Price Cap Plan.¹⁰⁵

¹⁰⁰ Eckert Direct Testimony, pp. 4-6.

¹⁰¹ Eckert Direct Testimony, p. 17.

¹⁰² Eckert Direct Testimony, p. 5.

¹⁰³ Eckert Direct Testimony, p. 7.

¹⁰⁴ Eckert Direct Testimony, p. 7.

¹⁰⁵ Eckert Direct Testimony, p. 5.

1 **Q: IS THIS A SOUND BASIS FOR PERPETUATING EXCESSIVE, DISTORTING**
2 **INTRASTATE ACCESS RATES?**

3 **A:** No. The facts to which Qwest admits are more than sufficient for the Commission to
4 conclude that it would be in the public interest to require Qwest to reduce its intrastate
5 rates to its interstate levels. There is no economic or policy justification in the context of
6 this proceeding for Qwest's excessive and distorting intrastate rates to be perpetuated.

7 **Q: MS. ECKERT ARGUES THAT QWEST'S INTRASTATE SWITCHED ACCESS**
8 **RATE IS THE "IDEAL" TARGET LEVEL FOR ALL LECs IN ARIZONA.¹⁰⁶**
9 **DO YOU AGREE?**

10 **A:** No, I do not. Qwest's proposal has no principled basis, and it has two sizable flaws: first,
11 there is no reason that the rates should be capped at Qwest's intrastate rate rather than its
12 interstate rate, and second, there is no sound basis for capping rates of LECs who operate
13 in territories other than Qwest's ILEC territory at Qwest's rates.

14 Ms. Eckert offers a number of arguments in support of Qwest's proposal: Qwest's access
15 rates are the lowest tariffed rates in the state; Qwest is the largest ILEC in Arizona;
16 targeting all rates to Qwest's level would mirror the FCC mandate; many other states
17 have followed this approach; and Qwest's rate is a commonly stated objective of access
18 agreements between IXC's and CLEC's.¹⁰⁷ Additionally, Ms. Eckert argues that intrastate

¹⁰⁶ *Eckert Direct Testimony*, p. 7.

¹⁰⁷ *Eckert Direct Testimony*, pp. 7-8.

1 access rates should be uniform across the entire state to truly reduce arbitrage
2 problems.¹⁰⁸ None of these arguments holds water.

3 **Q: SHOULD THE COMMISSION ESTABLISH QWEST'S INTRASTATE RATE AS**
4 **THE TARGET BECAUSE QWEST'S RATES ARE THE LOWEST IN THE**
5 **STATE?**¹⁰⁹

6 **A:** No. Qwest's intrastate access rates are not the lowest rates in the state for originating and
7 terminating functionality. In fact, Qwest's intrastate access rates are the *highest* rates that
8 *Qwest itself* charges in Arizona for the functionality of call origination and termination.
9 As I demonstrated in my Direct Testimony,¹¹⁰ Qwest's interstate access rates are lower
10 than its intrastate access rates, and its reciprocal compensation rates are lower still, all of
11 which are charged for the *same* functionality. AT&T's proposal that Qwest reduce its
12 intrastate rates to its interstate levels is not the extreme one of driving intrastate access
13 rates all the way to its reciprocal compensation rates (or, as the FCC proposed in 2008,
14 beyond that to zero) at this time; but neither is it the policy of inaction proposed by Qwest
15 in which Qwest, the largest carrier in the state, would make no reductions at all, even
16 though it already charges substantially lower rates for the same functionality in Arizona,
17 differentiated only by the regulatory category of the service.

¹⁰⁸ Eckert Direct Testimony, p. 7.

¹⁰⁹ Eckert Direct Testimony, p. 7.

¹¹⁰ Aron Direct Testimony, Figure 1 and Table 1.

1 Q: IS IT REASONABLE TO REQUIRE ALL LECS TO SET THEIR RATES AT
2 QWEST'S LEVEL BECAUSE QWEST IS THE LARGEST ILEC IN
3 ARIZONA?¹¹¹

4 A: No, the fact that Qwest is the largest ILEC in the state is why Qwest *must* reduce its
5 excessive intrastate rates for the full benefits of access reform to be enjoyed by residents
6 of Arizona. As I explained in my Direct Testimony, IXCs cannot discriminate in their
7 retail prices on the basis of the identity of the LEC serving the customer to whom they are
8 terminating, or from whom they are originating, traffic. Hence, retail prices respond to
9 the *average* access rate paid by the IXC. If the largest ILEC in the state does not reduce
10 its intrastate access rates, the effect on the state-wide average rate of the other reductions
11 taken by the other carriers will be muted. The effect on reducing intrastate long distance
12 prices will therefore be similarly muted, diminishing the benefit to long distance
13 customers and diminishing the benefits to intermodal competition.

14 Q: DOES QWEST'S PROPOSAL MIRROR THE FCC MANDATE, AS MS.
15 ECKERT ASSERTS?¹¹²

16 A: No. Mirroring the FCC mandate would be for each ILEC to charge the rate ordered by
17 the FCC for the same functionality in the interstate jurisdiction, and for each CLEC to
18 charge the same rate as the ILEC in the territory where it competes. That is what the FCC
19 ordered, and that is AT&T's proposal.

¹¹¹ Eckert Direct Testimony, pp. 7-8.

1 **Q: WOULD HAVING A UNIFORM RATE ACROSS THE STATE TEND TO**
2 **REDUCE ARBITRAGE, AS MS. ECKERT CLAIMS?**¹¹³

3 **A:** No, uniformity per se across the state for intrastate access is not the relevant factor. As I
4 explained earlier in response to ALECA, it is not diversity of rates across areas of the
5 state that induces arbitrage; it is the fact that rates are excessive in relation to the costs of
6 providing the service, and the fact that rates for a given carrier diverge between
7 functionally identical services. Reducing intrastate rates to interstate levels would
8 eliminate the potential for arbitrage via traffic-shifting between the interstate and
9 intrastate jurisdictions. It would also reduce the difference between intrastate rates and
10 costs, thereby reducing cost-price arbitrage opportunities.¹¹⁴

¹¹² *Eckert Direct Testimony*, p. 8.

¹¹³ *Eckert Direct Testimony*, p. 7.

¹¹⁴ Ms. Eckert asserts that benchmarking intrastate rates to the FCC (interstate) rates does not reduce arbitrage problems. The problem she is alluding to, however, as her subsequent discovery response makes clear, is that for some rural LECs the interstate rate is still so excessive that reducing intrastate rates to that level will not eliminate call pumping or certain other types of arbitrage activities. See, Qwest's Responses to AT&T Data Request 5-001. This may be true, but is not a problem this Commission can solve. Nor would Qwest's proposal better address it than AT&T's: regardless of the level to which a LEC's intrastate rate is reduced, any call pumping incentives created by excessive interstate rates will remain. AT&T's proposal will eliminate the incentive for traffic-shifting arbitrage between interstate and intrastate, even where the FCC rate is excessive. Qwest's proposal will not.

1 Q: MS. ECKERT ASSERTS THAT "MANY STATES HAVE FOLLOWED THIS
2 APPROACH" OF SETTING THE LECS' INTRASTATE RATES EQUAL TO
3 THE INTRASTATE RATE OF THE LARGEST ILEC IN THE STATE.¹¹⁵
4 PLEASE COMMENT.

5 A: States that have most recently implemented switched access reform have required CLECs
6 to mirror ILECs' intrastate rates, *but the ILECs are, in turn, required to mirror their*
7 *intrastate rates to their interstate rates.* In Massachusetts, as of an order issued last year,
8 CLECs are required to target their access rates to the intrastate rate of the largest ILEC in
9 the state, as Qwest proposes here.¹¹⁶ However, the largest ILEC, Verizon, is also required
10 to mirror its intrastate switched access rates to its interstate levels, so the cap effectively
11 sets CLEC rates *at the ILEC's interstate level*, not a higher intrastate level.¹¹⁷

12 Similarly, in New Jersey, the Board of Public Utilities recently ordered CLEC rates to be
13 capped at the intrastate rate of the ILEC with which it competes; and it also caps all
14 ILECs' intrastate rates at their interstate levels, the same proposal AT&T is making
15 here.¹¹⁸

¹¹⁵ Eckert Direct Testimony, p. 8.

¹¹⁶ 2009 Massachusetts Order, p. 30.

¹¹⁷ 2009 Massachusetts Order, p. 6. CLECs are permitted to exceed the cap only if they make a showing to the Commission that their costs exceed the rate cap. See, 2009 Massachusetts Order, p. 27. According to the CLECs' discovery responses in this case, none of them has ever made a cost showing to a state commission that resulted in the CLEC being able to charge rates above the cap.

¹¹⁸ New Jersey 2010 Order, pp. 28-29. Unlike AT&T's proposal here, New Jersey ordered that the rate reductions be phased in over 3 years.

1 Other states that have required CLECs to cap their intrastate access rates at ILECs' rates
2 are Ohio and Texas, where the CLECs' intrastate rates are capped at the intrastate rates of
3 the competing ILECs', and the ILECs' rates are, again, capped at the interstate level.¹¹⁹

4 **Q: IS IT REASONABLE FOR QWEST TO NOT HAVE TO REDUCE ITS**
5 **INTRASTATE ACCESS RATE ON THE GROUNDS THAT IT HAS ALREADY**
6 **REDUCED ITS RATES TO SOME EXTENT OVER THE LAST SEVERAL**
7 **YEARS?**¹²⁰

8 **A:** No. Although Qwest's intrastate access rates were decreased in Arizona on a number of
9 occasions in the last eight years, its intrastate rates remain well above the interstate rates
10 to which Qwest agreed in the interstate jurisdiction and that it has been charging for eight
11 years. In fact, Qwest's intrastate access rates in Arizona remain not only well above its
12 interstate rates ordered by the FCC, they are among the highest intrastate access rates
13 permitted for RBOCs *in the nation*. Specifically, looking at the major RBOCs across 48
14 US states,¹²¹ Qwest's intrastate access rates in Arizona are higher than the RBOCs'
15 intrastate access rates in all but nine states. Among the states in which Qwest is the
16 RBOC, Qwest's average intrastate rates in Arizona are sixth highest out of fourteen
17 states.

¹¹⁹ In Illinois there is not a generalized policy for CLECs but the Illinois Commerce Commission's decisions on individual CLECs have effectively capped their rates at the ILEC's interstate level. Some other states, including Maine and New Mexico, cap CLECs' intrastate switched access rates directly at their own interstate levels (which, again, are constrained by the FCC). See, *Aron Direct Testimony*, pp. 52-54.

¹²⁰ *Eckert Direct Testimony*, pp. 3, 5.

¹²¹ I was unable to collect intrastate rate information for Alaska and Hawaii for this comparison.

1 Q: PLEASE COMMENT ON MS. ECKERT'S CONTENTION THAT
2 AGREEMENTS BETWEEN IXCS AND CLECS ARE PROBATIVE THAT
3 QWEST'S RATE IS A REASONABLE TARGET RATE FOR OTHER
4 CARRIERS.¹²²

5 A: I do not have access to the agreements so I cannot test the assertion that "a majority" of
6 these agreements "benchmark to the ILEC rates;" nor whether the "ILEC rates" alluded to
7 by Ms. Eckert are the rates of the ILEC with whom the CLEC competes or are Qwest's
8 rates; nor whether the "ILEC rates" alluded to are tariffed interstate rates, tariffed
9 intrastate rates, or something else. Whatever they are, however, the agreed-upon rates
10 reflect the outcome of negotiations between IXCs with limited recourse and CLECs with
11 market power over switched access. Therefore, the only inference one can draw is that
12 the agreed-upon price is above the CLEC's costs of providing service and lower than
13 what the IXC would have to pay without the agreement. How much above the CLECs'
14 cost the price is cannot be determined by reference to the fact that the prices were agreed
15 to. Hence, there is no reason to consider the negotiated rates for switched access a
16 reasonable target as compared to the ILEC's interstate rates.

¹²² Eckert Direct Testimony, pp. 7, 11-12.

1 **VI. Response to the Direct Testimony of Don Price on Behalf of Verizon**

2 **Q: VERIZON PROPOSES THAT QWEST'S INTRASTATE RATE BE USED AS**
3 **THE TARGET LEVEL FOR INTRASTATE ACCESS RATES.¹²³ WHAT**
4 **ARGUMENTS DOES MR. PRICE OFFER IN SUPPORT OF THIS PROPOSAL?**

5 **A:** In addition to the same arguments posited by Qwest, to which I have already responded,
6 Mr. Price argues that Qwest's rates are the "prevailing market rate,"¹²⁴ and that Qwest's
7 rates "have historically been subject to the most regulatory scrutiny."¹²⁵

8 **Q: HAVE QWEST'S INTRASTATE RATE BEEN SUBJECT TO MORE**
9 **REGULATORY SCRUTINY THAN ITS INTERSTATE RATE?**

10 **A:** No. In fact, the ILECs' interstate rates were determined on the basis of an extensive,
11 multi-year, multi-party proceeding in which comments were provided by ILECs, CLECs,
12 state commissions, congressmen, consumer advocate groups, industry trade groups,
13 attorneys general, and others that culminated in the FCC's adoption of the rates that are in
14 effect today. The FCC found, in full recognition of the regulatory history and public
15 policy role that carrier switched access rates have historically played, the rates it adopted
16 to be beneficial to consumers, pro-competitive, and economically efficient.¹²⁶ In
17 addition, the *CALLS Order* permitted ILECs that did not wish to adopt the ordered rates

¹²³ *Price Direct Testimony*, p. 3. Mr. Price points that if the Commission declines to impose a single rate, then it should require CLECs to benchmark their rates at the competing ILEC's intrastate rates. See *Price Direct Testimony*, pp. 10-12.

¹²⁴ *Price Direct Testimony*, p. 13.

¹²⁵ *Price Direct Testimony*, pp. 15, 19.

1 to seek separate consideration by filing their own cost studies for consideration by the
2 FCC.¹²⁷ In fact, neither Qwest nor Verizon filed cost studies for special consideration by
3 the FCC, but chose to adopt the FCC's ordered interstate rates.¹²⁸

4 **Q: IS QWEST'S INTRASTATE RATE THE "PREVAILING RATE" IN**
5 **ARIZONA?**¹²⁹

6 **A:** No. If by "prevailing rate," Verizon means the rate most frequently charged, Qwest's
7 intrastate rate is certainly not the prevailing intrastate rate in Frontier's or Verizon's
8 territory in Arizona, since Qwest's intrastate rate is not charged there at all. In fact it is
9 also not the prevailing access rate in Qwest's *own* territory. The prevailing rate in its own
10 territory for switched access service is its *interstate rate*. Qwest sells about five times
11 more interstate access minutes than intrastate access minutes.¹³⁰ Hence, if anything,
12 Qwest's "prevailing rate" for originating and terminating functionality is its average
13 interstate access rate.

¹²⁶ FCC CALLS Order, ¶ 29.

¹²⁷ FCC CALLS Order, ¶ 57.

¹²⁸ I am aware of only one ILEC that sought forbearance from the *CALLS Order* rates, a small rural ILEC in Iowa that submitted a cost study to the FCC. See, Order, *In the Matter of Petition for Forbearance of Iowa Telecommunications Services, Inc. d/b/a/ Iowa Telecom Pursuant to 47 U.S.C. § 160(c) from the Deadline for Price Cap Carriers to Elect Interstate Access Rates Based on the CALLS Order or a Forward Looking Cost Study*, Before the Federal Communications Commission, CC Docket No. 01-331, FCC 02-323, (released November 26, 2002); and Order on Reconsideration, *In the Matter of July 1, 2003 Annual Access Charge Tariff Filings*, Before the Federal Communications Commission, WCB/Pricing No. 03-15, FCC 03-295, (released November 17, 2003).

¹²⁹ *Price Direct Testimony*, p. 13.

¹³⁰ Qwest's Response to Staff Data Request 1.1.

VII. Response to the Direct Testimony of Dr. Ben Johnson on Behalf of RUCO

Q: DO YOU HAVE ANY GENERAL COMMENTS ABOUT DR. JOHNSON'S TESTIMONY?

A: Yes. Unfortunately, Dr. Johnson has entirely ignored all of the testimony that was filed in this case weeks before his testimony was due; other than acknowledging its existence at the beginning of his testimony, he does not mention any of it even once. He raises issues that were examined in parties' testimonies without acknowledging the facts or issues already presented, and therefore his testimony is essentially disengaged from the current state of the debate in this case. This disengagement is compounded by the fact that his testimony is largely rooted in the issues and concerns of the telecommunications marketplace of a decade ago or more. He has declined to seriously grapple with the realities and facts of the current state of affairs in the market, such as the impact of the ubiquity of wireless telephony and the growth of VoIP on concerns about overall telephone penetration, a central topic of his testimony. Nevertheless, because he does not make any clear policy recommendations and because much of his testimony does not appear to me to lead to discernible policy recommendations, I will not respond to most of his testimony but will focus on just a few key points and issues. My very limited response should not be interpreted as agreement with any of Dr. Johnson's remarks about which I have not commented.

1 **Q: WHAT IS HIS MAIN POINT?**

2 A: I believe that what Dr. Johnson is saying in his testimony is that the Commission is
3 charged with pursuing possibly conflicting policy goals of equity, efficiency, and
4 universal service, and that by reducing switched access rates the Commission must take
5 due care to recognize that increasing local exchange rates by a corresponding amount
6 could jeopardize goals of universal service.¹³¹ It appears that one of his main points is to
7 urge the Commission to "carefully think through the consequences of any future
8 reduction or elimination in intrastate access charges, and develop a plan which will help
9 minimize the adverse consequences of any such changes."¹³²

10 **Q: WHAT ARE THE ADVERSE CONSEQUENCES TO WHICH HE REFERS?**

11 A: Dr. Johnson appears to be concerned about the possible effect of retail price increases on
12 telephone penetration.

13 **Q: IS THAT A VALID CONCERN?**

14 A: I addressed this concern in my Direct Testimony. I explained that while the potential
15 effects of retail price increases on overall telephone penetration is certainly an issue that
16 regulators must attend to, the evidence suggests that at least some increase in retail rates

¹³¹ See, for example, *Johnson Direct Testimony*, p. 24.

¹³² *Johnson Direct Testimony*, p. 48.

1 is tolerable.¹³³ Dr. Johnson's testimony fails entirely to recognize that 97 percent of the
2 population in Arizona over the age of 15 has a wireless phone,¹³⁴ and that the wireless,
3 wireline, and VoIP networks are interconnected; and fails to appreciate the implications
4 of these 21st century realities for universal service. As I discussed in my Direct
5 Testimony, even if increasing retail wireline prices caused some customers to drop their
6 wireline telephone service, this would not necessarily have any effect at all on universal
7 service or telephone penetration if those customers choose to rely on other technologies to
8 meet their communications needs.¹³⁵ Only to the extent that price increases cause
9 customers to drop their wireline phone and to not subscribe instead to cable telephony,
10 wireless, or some other form of telephony, would retail rate increases possibly impact
11 goals of universal service.

12 Nevertheless, it is certainly reasonable to advise the Commission to "think through the
13 consequences" of reducing access rates and develop a plan to minimize any potential
14 adverse consequences. This is precisely what AT&T did in Dr. Oyefusi's Direct
15 Testimony, wherein Dr. Oyefusi proposed a number of options for implementing access
16 reform that would ease any burden on consumers.

¹³³ Aron Direct Testimony, pp. 93-99.

¹³⁴ "Local Telephone Competition: Status as of June 30, 2008," Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, July 2009, Table 14; and US Census Bureau, "2008 American Community Survey, Selected Population Profile in the United States - Arizona."

¹³⁵ Aron Direct Testimony, pp. 93-95.

1 **Q: PLEASE EXPLAIN.**

2 **A:** In response to possible concerns that immediate retail rate increases that would
3 compensate ILECs for forgone access revenues would cause rate shock or declines in
4 telephone penetration, AT&T proposed to reduce intrastate access rates to interstate rates
5 immediately, but phase in price increases over time to replace that revenue by setting a
6 maximum annual price increase. The forgone revenue that is not recovered through the
7 annual increase would be replaced with AUSF funds in the short run, but the AUSF
8 support would be decreased and the retail price would be increased until it reaches an
9 established benchmark over a measured period of time (for example, two years) to
10 minimize rate shock.¹³⁶ Such a plan would provide Arizona long distance customers with
11 the benefits from reduced access rates immediately, would reduce incentives for arbitrage,
12 and would decrease the distortions to intermodal long distance competition, while
13 phasing in the necessary retail rate increases over time and to a level that the Commission
14 considers acceptable and consistent with universal service goals. This plan meets Dr.
15 Johnson's objectives of increasing efficiency (by decreasing access rates right away)
16 while moving slowly and deliberately on retail price increases that he believes could
17 reduce telephone penetration.

¹³⁶ See, Direct Testimony of Dr. Ola Oyefusi on Behalf of AT&T Communications of the Mountain States, Inc. and TCG Phoenix, *In the Matter of the Review and Possible Revision of Arizona Universal Service Fund Rules, Article 12 of the Arizona Administrative Code and In the Matter of the Investigation of the Cost of*

1 **Q: DID DR. JOHNSON RESPOND TO OR COMMENT ON THESE PROPOSALS?**

2 A: No. He did not acknowledge them.

3 **Q: IS DR. JOHNSON CORRECT IN HIS SUGGESTION THAT AT&T IS**
4 **PROPOSING TO BE ABLE TO USE LECS' NETWORKS "WITHOUT PAYING**
5 **ANYTHING FOR THIS PRIVILEGE,"¹³⁷ OR ASKING FOR A "FREE RIDE"?¹³⁸**

6 A: No. AT&T is proposing to pay rates that by all evidence exceed the ILECs' costs of
7 providing switched access service to AT&T. Dr. Johnson is simply incorrect and out of
8 step with economic thinking to suggest that IXC's would get a "free ride" if they do not
9 contribute to the cost of building a loop, as I explained at length earlier. The cost
10 associated with switched access is the cost of switching and associated transport, not the
11 cost of the loop.

12 **Q: PLEASE COMMENT ON DR. JOHNSON'S VIEW THAT "THE COMMISSION**
13 **SHOULD PLACE A VERY HIGH BURDEN OF PROOF ON PARTIES THAT**
14 **ARE URGING EXTREME CHANGES TO COST RECOVERY PATTERNS**
15 **WHICH HAVE PROVEN SO SUCCESSFUL FOR SO MANY YEARS."¹³⁹**

16 A: It is astonishing that Dr. Johnson could have read ALECA's testimony (not to mention
17 that of AT&T or Sprint) and continue to believe that the current system of cost recovery
18 that requires rural ILECs to rely on the crumbling and antiquated system of excessive

Telecommunications Access, Before the Arizona Corporation Commission, Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672, December 1, 2009, pp. 63-68.

¹³⁷ *Johnson Direct Testimony*, p. 9.

¹³⁸ *Johnson Direct Testimony*, p. 17.

¹³⁹ *Johnson Direct Testimony*, p. 37.

1 access rates is "so successful." In fact, even aside from the harms to competition and
2 efficiency that I have discussed, the current system of access rates is *not* successful any
3 longer even for its original purpose of subsidizing local exchange companies. It is no
4 longer successful because, as I have explained and as ALECA has made clear in its
5 testimony and white paper, access revenues are no longer a reliable source of subsidy.
6 They create a self-reinforcing downward spiral of support for LECs because high access
7 rates force wireline long distance rates up, which makes wireline long distance service
8 less competitive relative to wireless and other technologies that do not pay access rates to
9 the same extent as do wireline IXC's, or do not pay them at all; customers migrate from
10 wireline to other forms of long distance communication; and access revenues dry up for
11 the LECs that they historically supported.

12 I would also note that, as I just explained, AT&T is not proposing any policy reform that
13 would necessarily confront consumers with "extreme" changes, because AT&T's
14 proposal includes options that would bring changes to wireline local exchange
15 consumers' prices at a phased-in pace determined by the Commission.

1 Q: ACCORDING TO DR. JOHNSON, "WHILE REDUCING ACCESS RATES MAY
2 BENEFIT SOME CARRIERS, THE POLICY CHANGES BEING ADVOCATED
3 IN THIS CASE WON'T NECESSARILY HELP NEW ENTRANTS GAIN A
4 FOOTHOLD IN THE MARKET."¹⁴⁰ PLEASE COMMENT.

5 A: "Helping new entrants gain a foothold in the market" is not a valid or responsible public
6 policy goal. Helping new entrants gain a foothold in the market means subsidizing them,
7 protecting them from competition, applying rules unequally to them, or otherwise
8 enhancing their ability to succeed beyond what the quality and costs of their own business
9 can accomplish. Such market intervention is harmful to competition and harmful to
10 consumers. This is a classic flaw associated with what is known as the "infant industry"
11 argument.

12 Often implemented in the form of tariffs to protect a fledgling domestic industry from
13 foreign competition, the "infant industry" rationale encourages policy makers temporarily
14 to handicap incumbents or offer preferences to their less-experienced rivals in order to
15 boost the latter's ability to compete and overcome the alleged advantages of incumbency.
16 There are many pitfalls associated with infant industry regulations, which cause
17 economists, as a whole, to question their wisdom in most circumstances.¹⁴¹

¹⁴⁰ Johnson Direct Testimony, p. 25.

¹⁴¹ Alfred E. Kahn and William E. Taylor, "The Pricing of Inputs Sold to Competitors: A Comment," *Yale Journal on Regulation* 11 (Winter 1994), pp. 225-240.

1 In general, it is very difficult to eliminate the preferential treatment once the entrants are
2 on their feet. Establishing undue regulatory protections of any sort encourages firms to
3 enter, make sunk investments, and thereby become reliant on the regulatory protections
4 under which their investments made economic sense. Some such providers may not be
5 viable at all without protection, and others may have made investments that would have
6 been excessive or unwise had the protection not been in place. Once the entrants are in
7 the market and investments are made, however, these parties become a visible political
8 factor and it may become difficult to abandon the protections that render them viable.
9 Indeed, we see this very phenomenon in this case, in which competitors who have
10 benefited from the opportunity to charge excessive access rates now appeal to the
11 regulator to perpetuate that policy in order to protect their business models.

12 In addition, any regulation that protects a class of competitors from competition imposes
13 a cost stemming from its interference with the efficient distribution of supply among
14 competitors on the basis of their relative costs. Competition is facilitated, efficiency
15 promoted, and consumers benefited when regulators establish conditions under which
16 efficient competitors will survive and inefficient competitors will either improve or exit.
17 As the CLECs themselves admitted in discovery when asked what alterations they would

1 have to make to their business plans if access rates were lowered to Qwest's interstate
2 level, "CLECs would have to look for ways to offset reduced revenue or cut their cost."¹⁴²

3 In any event, if the Commission did choose to intervene in the market by "helping" new
4 entrants "gain a foothold" in the market, there is no policy or economic justification for
5 doing so by requiring wireline IXC's and their customers to provide the subsidy. Such a
6 subsidy policy should be borne by all consumers and should be exposed to the court of
7 public opinion by being funded through explicit means. Finally, providing a subsidy to
8 "new entrants" through excessive intrastate access rates would equally provide a subsidy
9 to competitive firms such as the Joint CLECs and Cox, who are hardly "new," have been
10 operating in Arizona for at least eight years, and (in the case of XO and tw telecom) are
11 multinational corporations.

12 **VIII. Response to the Direct Testimony of Wilfred Shand on Behalf of Staff**

13 **Q: DO YOU HAVE ANY OVERALL COMMENTS ON STAFF'S TESTIMONY?**

14 **A:** Yes. Staff correctly articulates four benefits of access reform:¹⁴³

- 15 1. Price efficiency
16 2. Reduction of arbitrage opportunities

¹⁴² Joint CLECs' Response to AT&T Data Request ATT 1-3, response subject to the objection that the term "business plan" is "vague and ambiguous."

¹⁴³ *Shand Direct Testimony*, p. 9.

- 1 3. Elimination of differences in rates that occur because of regulatory decisions
2 4. Establishment of more consistent and rational intrastate switched access rates.

3 However, like Qwest and ALECA, Staff's proposed reform would not achieve the
4 benefits it has identified. Staff proposes that ALECA members and the CLECs be
5 required to reduce their rates to Qwest's intrastate level.¹⁴⁴ Staff proposes to exempt
6 Qwest from any rate reductions.¹⁴⁵ I explained in my response to Ms. Eckert and Mr.
7 Meredith why such a proposal is inadequate to address the policy goals that are listed
8 above.

9 **Q: WHAT IS STAFF'S RATIONALE FOR EXCLUDING QWEST FROM ACCESS**
10 **RATE REDUCTIONS?**

11 **A:** Staff's only rationale appears to be that Qwest has already made access rate reductions.¹⁴⁶

12 **Q:** **IS THAT A GOOD REASON TO EXCLUDE QWEST FROM ACCESS REFORM**
13 **IN THIS CASE?**

14 **A:** No. As I have already discussed, although Qwest has made some progress, that does not
15 mean that the Commission should stop moving forward or that Qwest's current intrastate
16 switched access rates are just and reasonable for consumers. Qwest's intrastate switched
17 access rates are still well above its corresponding interstate rates. As I have explained,
18 the Commission's objective in this case should not be to protect some carriers or to

¹⁴⁴ *Shand Direct Testimony*, pp. 2, 11.

¹⁴⁵ *Shand Direct Testimony*, p. 3.

1 balance carriers' interests. It should be to advance consumer welfare by promoting a
2 more efficient rate structure and thereby facilitating competition on the merits. As the
3 largest carrier in Arizona, Qwest's rates have the greatest influence on average intrastate
4 access prices borne by IXC's and, in turn, their customers. There is no sound public
5 policy reason to protect Qwest's access revenue flow by preserving excessive rates at the
6 expense of Arizona customers and in contravention of sound policy principles.

7 **Q: STAFF ALSO PROPOSES THAT IXCS BE REQUIRED TO MAKE A FILING**
8 **WITH THE COMMISSION TO DEMONSTRATE THAT THEY HAVE PASSED**
9 **THROUGH ACCESS RATE REDUCTIONS.¹⁴⁷ PLEASE COMMENT.**

10 **A:** I would caution the Commission that there are a number of practical impediments to
11 actually enforcing such a requirement, at least if what Staff means is that AT&T would be
12 required to demonstrate 100% (or any other specific level of) pass-through. These
13 impediments would make enforcement resource-intensive, for a requirement that is not
14 necessary. The evidence shows that market mechanisms will result in a significant degree
15 of flow-through in any event.

16 Any carrier's retail rate structure consists of multiple rate plans, including discount plans
17 that may be available only for a defined period of time; recurring and non-recurring rates;
18 and new and discontinued rate plans. In addition, a carrier's access expense is a

¹⁴⁶ *Shand Direct Testimony*, p. 3.

¹⁴⁷ *Shand Direct Testimony*, p. 13.

1 combination of the rates charged by each LEC, the particular combination depending on
2 the number of access minutes purchased from each LEC. If some or all LECs reduce
3 their access rates, the amount by which IXCs' access expenses decline in total and on a
4 per-minute basis will vary from one IXC to another, and from one time period to another.

5 With respect to the retail rates, a rational IXC will respond to a reduction in access rates
6 by reducing retail prices, but how it reduces its retail prices could take many forms. For
7 example, it could offer discounts on existing plans; it could focus greater resources on
8 encouraging new customers to purchase existing discounted rate plans; it could focus
9 greater resources on encouraging customers to switch from existing higher-priced to
10 lower-priced rate plans; it could introduce new rate plans while keeping the old ones; it
11 could grandfather certain higher-priced existing rate plans while not introducing new
12 plans; it could reduce volume-sensitive (per minute) rates on existing plans; it could
13 reduce non-volume-sensitive rates on existing plans; it could increase the number of
14 minutes offered for a given flat price; it could expand the times of day in which lower
15 rates apply; or any number of other possibilities. Any or all of these rate changes would
16 decrease the average price paid by customers for long distance services. I would expect
17 an IXC to attempt to monitor the pricing changes of its competitors and to engage in a
18 certain amount of market research and trial and error to determine which kinds of rate
19 plan changes would be most effective at profitably attracting more customers in response

1 to its lower costs. Like any rate change the effects on customers' demand and usage, and
2 therefore the effect on average and total retail revenues, would be uncertain for the IXC
3 and variable over time.

4 The "access rate reduction" for each IXC resulting from an ordered reduction in access
5 rates would have to be computed as the difference between an average rate paid by that
6 IXC over a specified period of time before the rate change, and an average rate paid (or
7 total access expense) by that IXC over a specified period after the rate change. These
8 calculations will be sensitive to the time period chosen for analysis, as well as exogenous
9 factors outside the control of the IXC, such as consumer switching between wireline local
10 and wireless service, VoIP, and other services, and overall economic conditions. That is,
11 some (generally unpredictable) component of the measured change in total and average
12 access expenses will be the result of factors other than the change in access rates.

13 The actual average "retail rate reduction" associated with reductions to access rate
14 elements would similarly have to be computed as the difference between an average paid
15 by consumers to that IXC over some period of time before the access rate reduction and
16 an average paid by consumers to the IXC over some period of time after the access rate
17 reduction. Alternatively, the reduction could be computed as total revenue reduction
18 rather than on a per-minute basis. In either case the reduction will depend on the time

1 period chosen and factors such as secular declines in wireline long distance demand,
2 population growth, and economic conditions.

3 Quantifying the amount by which actual access rate reductions were "passed through" in
4 Arizona in order to assess whether the pass through meets a given standard would
5 therefore require comparing the measured reduction in average (or total) access rates paid
6 with the measured reduction in average revenues, and attempting to control for exogenous
7 factors. My point is not that this is necessarily impossible, but that such an analysis
8 would be very resource intensive and costly, and achieving results with high degrees of
9 confidence may in fact be impossible.¹⁴⁸ It is not a mechanical exercise, and determining
10 whether the pass through actually achieved by a given carrier in a single state was really
11 100% or any other specific level would require data and control variables that may or may
12 not be available. In fact, when asked in discovery whether they have passed through
13 access rate reductions in the states in which they provide long distance service, the
14 CLECs responded that they did not know and such a determination would require an
15 "extensive special study."¹⁴⁹

¹⁴⁸ This exercise is significantly more challenging than testing whether decreased access rates cause retail rates to fall on average, as I did, because the latter can be tested by looking at the relationship between retail prices and access rates across all states and multiple time periods.

¹⁴⁹ Joint CLECs' Responses to AT&T Data Requests ATT 1-10 and ATT 1-11.

1 Such an analysis is not needed for the Commission to protect consumers' interests in
2 Arizona. As I explained in my Direct Testimony, IXCs have both a profit incentive and a
3 competitive impetus to decrease retail prices in response to reduced access rates, and the
4 data are persuasive that they in fact do so.

5 **Q: STAFF CLAIMS THAT INTERSTATE ACCESS CHARGES ARE LOWER**
6 **THAN INTRASTATE RATES BECAUSE THE FCC INSTITUTED THE SLC,**
7 **FOR WHICH THERE IS NO INTRASTATE EQUIVALENT.¹⁵⁰ IS THAT**
8 **CORRECT?**

9 **A:** No. The equivalents to the SLC (the Subscriber Line Charge) in the intrastate arena are
10 local exchange prices themselves. The logic of creating the SLC was so that cost
11 recovery would more closely follow cost-causation, which means that the cost of the loop
12 should be recovered through flat-rated (not usage sensitive) charges imposed on
13 customers (not IXCs). The direct way to accomplish this is to increase retail prices to
14 customers for local exchange access. Unlike the Commission, however, the FCC does
15 not have the authority or jurisdiction over local exchange prices to do so. Hence, the
16 FCC adopted its next-best alternative, which was largely to permit the revenue reductions
17 from reduced interstate traffic-sensitive access rates to be recovered in fixed (non-traffic-
18 sensitive) fees (the SLC) that are charged to subscribers, not to carriers.

¹⁵⁰ *Shand Direct Testimony*, p. 4.

1 In fact, the FCC has been very clear that its objective throughout the last 25 years of
2 access rate reform has been to reduce the subsidy burden on IXC's, and to modify the
3 interstate access rate structure so that it more closely follows cost causation and recovers
4 the costs of local service from local service subscribers. In implementing the interstate
5 access regime in 1983, the FCC concluded as follows:

6 The driving force behind our decision to move toward flat [charges] is our
7 commitment to promoting efficient use of the nationwide
8 telecommunications network and our recognition that pricing reform is
9 necessary to enable our society to maximize its efficient use of the
10 telecommunications network and realize the benefits possible from
11 increasing competition in the interexchange marketplace. Artificial
12 pricing structures, while perhaps appropriate for use in achieving social
13 objectives under the right conditions, cannot withstand the pressures of a
14 competitive marketplace. We see the imposition of moderate flat charges
15 on telephone subscribers as an effective, orderly and fair means of guiding
16 telecommunications pricing in the direction which it inevitably must take,
17 toward efficient, cost-based rates. The concept that users of the local
18 telephone network should be responsible for the costs they actually cause
19 is sound from a public policy perspective and rings of fundamental
20 fairness. It assures that ratepayers will be able to make rational choices in
21 their use of telephone service, and it allows the burgeoning
22 telecommunications industry to develop in a way that best serves the needs
23 of the country.¹⁵¹

24 Over a decade later, in its *Access Charge Reform Order* (1997), the FCC again clearly
25 articulated its objective to adhere to cost-causation principles as follows:

¹⁵¹ Memorandum Opinion and Order, *In the Matter of MTS and WATS Market Structure*, Before the Federal Communications Commission, CC Docket No. 78-72, Phase I, FCC 83-356, (released August 22, 1983), 97 F.C.C.2d 682 at ¶ 7.

1 The Commission has recognized in prior rulemaking proceedings that, to
2 the extent possible, costs of interstate access should be recovered in the
3 same way that they are incurred, consistent with principles of cost-
4 causation. Thus, the cost of traffic-sensitive access services should be
5 recovered through corresponding per-minute access rates. Similarly, NTS
6 [non-traffic sensitive] costs should be recovered through fixed, flat-rated
7 fees.¹⁵²

8 The FCC's approach to rate reform has therefore been to modify interstate rates so that
9 the costs of local exchange service are recovered from local exchange subscribers using
10 the pricing tools it had available. The Commission can achieve the same objective by
11 replacing subsidies embedded in intrastate traffic-sensitive carrier access rates with the
12 opportunity to recover costs via increased retail prices for local services.

13
14 **Q: DOES THIS COMPLETE YOUR REPLY TESTIMONY?**

15 **A: Yes.**

¹⁵² First Report and Order, *In the Matter of Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers et al.*, Before the Federal Communications Commission, CC Docket Nos. 96-262 and 94-1 et al., FCC 97-158, (released May 16, 1997), ¶ 24.

Arizona Docket Nos. RT-00000H-97-0137 and T-00000D-00-0672
Joint CLEC
Request No. 1
DR.6

Question: In Docket WC Docket No. 06-147, Petition of the Embarq Local Operating Companies for Forbearance Under 47 U.S.C. § 160(c) from Application of Computer Inquiry and Certain Title II Common-Carriage Requirements, the FCC noted with respect to enterprise customers:

We also observe the sophistication of the enterprise customers that tend to purchase broadband telecommunications services. The Commission consistently has recognized that customers that use specialized services, similar to the petitioner-specified services, demand the most flexible service offerings possible, and that service providers treat them differently from other types of customers, both in the way they market their products and in the prices they charge. These users tend to make their decisions about communications services by using either communications consultants or employing in-house communications experts. This shows that customers are likely to make informed choices based on expert advice about service offerings and prices, and thus suggests that these users also are likely to be aware of the choices available to them. The Commission has further found that the *large revenues* these customers generate, and their need for reliable service and dedicated equipment, provide a significant *incentive to suppliers to build their own facilities* where possible, and to carry the traffic of these customers over the suppliers' own networks. (Paragraph 23.) (Emphasis added.) Para 24. Even in situations where competitors do not have the option of self-deploying their own facilities or purchasing inputs from carriers other than the incumbent LEC, potential providers may rely on *special access services* purchased from the incumbent LEC at rates subject to price regulation. (Paragraph 24) With respect to this statement, please answer the following questions:

- a. Does Dr. Aron agree with the FCC's assessment that "the large revenues these customers generate, and their need for reliable service and dedicated equipment, provide a significant *incentive to suppliers to build their own facilities* where possible, and to carry the traffic of these customers over the suppliers' own networks." Further, please explain the extent to which the same can be said where it concerns originating switched access services to enterprise customers? To the extent that Dr. Aron believes that suppliers do not have incentives to build their own facilities to serve such enterprise customers, please (a) explain why that is so, and (b) do suppliers never have such incentives, no matter how large the enterprise customers or does it depend on the size of the customer (please explain.)?
- b. Please admit or deny that In New Jersey Docket No. TX08090830, Dr. Aron testified that special access services can be used to accommodate access traffic and are a competitive alternative to switched access services. To the

extent that Dr. Aron denies the statement, please discuss the extent to which she does believe that special access services and switched access services are competitive alternatives for (i) originating traffic, and (ii) terminating traffic.

- c. Please discuss the extent to which Dr. Aron believes that self-provisioning of facilities offer an alternative to the CLECs' access facilities for (i) originating traffic, and (ii) terminating traffic.

Response:

- a. AT&T objects to this question on the grounds that it is irrelevant to this proceeding and not reasonably calculated to lead to the discovery of admissible evidence. Without waiving that objection, AT&T responds as follows:

It is not clear whether the question refers to special access dedicated facilities or switched dedicated facilities (e.g., direct trunking facilities). AT&T assumes the question implies the former, and the answer is "yes." With respect to originating switched access to enterprise customers, for any given customer for whom the cost of building facilities to that customer is K , and for any level of switched access cost r charged by the LEC serving that customer, there will generally exist some finite level of originating access minutes $N^*(r)$ such that if that customer's originating access minutes of use exceeded $N^*(r)$ it would be optimal for a supplier to build a dedicated facility to that customer to bypass the switched access. However, this case is about reform of switched access charges levied for calls to customers whose traffic volumes are less than $N^*(r)$ and for whom it would therefore not be economical to build a special access facility. Since the CLECs' switched access rates will not apply to the special access or dedicated facilities being referenced, and because the availability of special access for customers whose traffic volumes justify special access will not and does not adequately discipline prices for switched access services (see response to part (c) below) this question is irrelevant to this proceeding.

- b. In New Jersey Dr. Aron's prefiled written testimony did not address special access. Her oral testimony addressing special access consisted in its entirety as follows:

Cross Examination by Eric Krathwohl, counsel for the 9 Joint CLECs of New Jersey:

MR. KRATHWOHL:

2 Q Good afternoon, Doctor.

3 A Good afternoon, sir.

4 Q Is it correct that AT&T provides switched
5 access services?

6 A AT&T, the company, the parent company, AT&T New
7 Jersey?

8 Q Let's start with AT&T New Jersey?

9 A AT&T, the broader company, does.

- 10 I don't know about the various corporate
11 entities.
12 Q And whichever entity does provide switched
13 access services, would you say that it has market
14 power with respect to such provision of services?
15 A Yes.
16 Q Would you agree that switched access and
17 special access services are sometimes substituted?
18 A In some cases they are for certain types of
19 large business customers.

See, Hearing Transcripts, before the State of New Jersey Board of Public Utilities,
Docket No. TX08090830, September 15, 2009, p. 142.

- c. Self-provisioning of facilities provides an alternative to CLECs' access service as described in (a) and articulated in (b). This alternative will not discipline the LEC's access rates to a cost based level, however. To see this, let $f(N)$ be the frequency distribution of LEC i 's customers as a function of the access usage N of each customer. (I will treat $f(\cdot)$ as continuous but this is without loss of generality). Let $k \geq 0$ be the per minute cost of providing switched access. Then i 's profits from switched access are

$$\pi = \int_{N_0}^{N^*(r)} (r - k) N f(N) dN,$$

where N_0 is the access usage level of the customer(s) served by LEC i that has (have) the lowest access usage, and $N^*(r)$ is as defined in (a). Maximizing profit with respect to r yields the first order condition

$$\int_{N_0}^{N^*(r^*)} N f(N) dN + (r^* - k) N^*(r^*) f(N^*(r^*)) \frac{dN^*(r^*)}{dr} = 0.$$

$N^*(r)$ satisfies the condition $\frac{K}{N^*(r)} \equiv r$ for all r . Hence, $\frac{dN^*(r^*)}{dr} < 0$.

Therefore, r^* strictly exceeds k as long as N_0 is strictly less than $N^*(r^*)$. But a rational LEC would not choose $N_0 = N^*(r^*)$ because it would ensure zero profits while $N_0 < N^*(r^*)$ will ensure positive profits.

Responsible Person: Dr. Aron

Table 1

CLEC Statements Regarding Regulation of Access Rates

Date	Filing	Company	Statement
Mar-98	1997 10K	McLeodUSA	[Interstate] access rates make up a significant portion of the cost of providing long distance service. The FCC has recently implemented changes to its interstate access rules that result in restructuring of the access charge system and changes in access charge rate levels. These changes reduce per-minute access charges and substitute new per-line flat-rate monthly charges. These actions, along with additional changes which may occur later this year and in subsequent years, may reduce access rates, and hence the cost of providing long distance service, especially to business customers. However, the impact of the FCC's new decisions will not be known until those decisions are fully implemented over the next several years, during which time those decisions may be revised.
Mar-98	1997 10K	McLeodUSA	States also regulate the intrastate carrier access services of the incumbent local exchange carriers. The Company is required to pay access charges to originate and terminate its intrastate long distance traffic. The Company could be adversely affected by high access charges, particularly to the extent that the incumbent local exchange carriers do not incur the same level of costs with respect to their own intrastate long distance services.
Mar-98	1997 10K	McLeodUSA	[A] substantial proportion of [McLeodUSA's subsidiary] ICTC's revenues are derived from access charges imposed on interexchange carriers. Access charge rate structures and rate levels have been modified by recent regulatory changes, and further changes are possible. If such revisions result in a reduction of ICTC's revenues and gross margins, it could have a material adverse effect on the Company.
Mar-98	1997 10K	Electric Lightwave	The [FCC's] new rules [regarding interstate access] substantially increase the costs that ILECs subject to the FCC's price cap rules (price cap local exchange carriers), recover through monthly, non-traffic sensitive access charges and substantially decrease the costs that price cap LECs recover through traffic sensitive access charges. In the May 16 order, the FCC also announced its plan to bring interstate access rate levels more in line with cost. The manner in which the FCC implements this approach to lowering access charge levels may have a material adverse effect on the Company's ability to compete in providing interstate access services.

Arizona Corporation Commission
Docket No. RT-00000H-97-0137
Docket No. T-00000D-00-0672
Reply Testimony of Dr. Debra J. Aron
Exhibit DJA-R2

Date	Filing	Company	Statement
Mar-99	1998 10K	McLeodUSA	The FCC and various states are considering changes to access charge rate levels and related issues involving support for universal service and other public policy objectives. The impact of these changes on us and our competitors is not yet clear. We could be adversely affected if we do not experience access cost reductions proportionally equivalent to those of our competitors, if our competitors receive a disproportionate share of universal service revenues, or if regulation of incumbent local exchange carriers' access services is reduced. As long as new Internet-based competitors continue to be exempt from these charges, they could enjoy a significant cost advantage in this area.
Mar-00	1999 10K	tw telecom	<p>If regulatory decisions permit the ILECs to charge CAPs and CLECs substantial fees for interconnection to the ILECs' networks or afford ILECs other regulatory relief, such decisions could also have a material adverse effect on the Company. However, the Company believes that the negative effects of the 1996 Act may be more than offset by:</p> <ul style="list-style-type: none"> . the increased revenue available as a result of being able to address the entire local exchange market; . reciprocal compensation with the ILEC; . obtaining access to off-network customers through more reasonably priced expanded interconnection with ILEC networks; and . a shift by IXCs to purchase access services from CAPs and CLECs instead of ILECs. <p>There can be no assurance, however, that these anticipated results will offset completely the effects of increased competition as a result of the 1996 Act.</p>
Mar-00	1999 10K	tw telecom	<p>[T]he FCC is considering proposals to decrease ILEC per-minute access charges, while imposing regulation on CLEC access charges to restrict rates to levels below an established benchmark. Although the Company's business plans have reflected downward pressure on access rates and their impact, these regulatory developments may potentially result in lower rates than anticipated. Management believes that increased volume in services and markets served will offset the impact of switched access rate reduction. However, the degree and timing of the regulatory developments cannot be predicted. In addition, there is no assurance that the Company will be able to compensate for the reduction in switched access revenue from rate reform with other revenue sources.</p>

Arizona Corporation Commission
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Exhibit DJA-R2

Date	Filing	Company	Statement
Mar-01	2000 10K	XO	Long distance carriers pay local carriers, including us, interstate access charges for both originating and terminating the interstate calls of long distance customers on the local carriers' networks. Historically, the RBOCs set access charges higher than cost and justified this pricing to regulators as a subsidy to the cost of providing local telephone service to higher cost customers. ... The method selected and the timing of a FCC decision to lower access charge levels or a FCC decision requiring that competitors' access rates be set through negotiation rather than tariffing may reduce access charge revenue that we receive from long distance carriers. Although a FCC decision lowering access charges may reduce our access charge revenues, we do not expect that such a reduction would have a material impact on our total revenues or financial position.
Mar-02	2001 10K	XO	[T]he FCC issued a decision in 2001 setting the rates that competitive local carriers charge to long distance carriers at a level that will gradually decrease over the next three years ... Although this FCC decision lowering access charges will reduce our access charge revenues over time, we do not expect that such a reduction will have a material impact on our total revenues or financial position.
Feb-03	2002 10K	tw telecom	In May 2000, the FCC ordered a substantial reduction in ILEC per-minute access charges and an increase in the flat monthly charge paid by local residential service subscribers for access to interstate long distance service. The FCC also released an order effective in June 2001 that subjects CLECs' interstate switched access charges to regulation. Effective with that order, our rates were reduced and will continue to decline through June 2004 to parity with the ILEC rates competing in each area. ... There is no assurance that any legal challenge [to this order] will be successful or that a successful challenge will change the trend toward lower access charges. The ILEC access reform decision, as well as the CLEC access charge regulation have resulted in reductions in the per-minute rates we receive for switched access service in 2001 and 2002 and will result in further reductions through June 2004. There is no assurance that we will be able to compensate for reductions in switched access revenue resulting from the FCC order with revenue from other sources.

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Reply Testimony of Dr. Debra J. Aron
Exhibit DJA-R2

Date	Filing	Company	Statement
Mar-05	2004 10K	Eschelon	We purchase long distance service on a wholesale basis from an IXC who pays access fees to local exchange carriers for the origination and termination of our long distance communications traffic. Generally, intrastate access charges are higher than interstate access charges. Therefore, to the degree access charges increase or a greater percentage of our long distance traffic is intrastate, our costs of providing long distance services will increase. As a local exchange provider, we bill long distance providers access charges for the origination and termination of those providers' long distance calls. Accordingly, in contrast with our long distance operations, our local exchange business benefits from the receipt of intrastate and interstate long distance traffic. ... The result of any changes to the existing regulatory scheme for access charges or a determination that we have been improperly recording the jurisdiction of our communications traffic could have a material adverse effect on our business
Mar-05	2004 10K	Eschelon	Our costs of providing long distance services, and our revenues for providing local services, also are affected by changes in access charge rates imposed on CLECs. Pursuant to the FCC's 2001 CLEC Access Charge Order, which lowered the rates that CLECs may charge long distance carriers for the origination and termination of calls over local facilities, access rates were reduced during Fiscal 2003 and Fiscal 2004. AT&T and Sprint have appealed the CLEC Access Charge Order to the D.C. Circuit, arguing that the FCC's benchmark rates are too high.
Mar-05	2004 10K	Eschelon	The FCC has stated that existing intercarrier compensation rules constitute transitional regimes and has promised to reform them. ... Because we both make payments to and receive payments from other carriers for the exchange of local and long distance calls, we will be affected by changes in the FCC's intercarrier compensation rules. We cannot predict the impact that any such changes may have on our business.
Mar-07	2006 10K	PAETEC	In general, the FCC benchmark rate policy may prevent PAETEC from raising its access charges with respect to the provision of some carrier services and its reciprocal compensation rates substantially above specified levels. Current FCC policies and regulations also have helped to maintain or reduce the rates that PAETEC's competitors may charge PAETEC for similar wholesale carrier services. As a result, PAETEC currently is able substantially to pass through cost savings to its network services customers. Nevertheless, the outcome of FCC's decisions on intercarrier compensation reform and its effect on PAETEC's business and the businesses of its competitors cannot be predicted.

Source: Company 10-Ks

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - Chairman

GARY PIERCE

PAUL NEWMAN

SANDRA D. KENNEDY

BOB STUMP

IN THE MATTER OF

**THE REVIEW AND POSSIBLE
REVISION OF ARIZONA
UNIVERSAL SERVICE FUND
RULES, ARTICLE 12 OF THE
ARIZONA ADMINISTRATIVE
CODE.**

DOCKET NO. RT-00000H-97-0137

**IN THE MATTER OF THE
INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.**

DOCKET NO. T-00000D-00-0672

REPLY TESTIMONY OF

DR. OLA OYEFUSI

On Behalf of

AT&T Communications of the Mountain States, Inc. and TCG Phoenix

PUBLIC VERSION

February 5, 2010

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1 **I. INTRODUCTION AND SUMMARY**

2
3 **Q. ARE YOU THE DR. OYEFUSI WHO SUBMITTED DIRECT TESTIMONY ON**
4 **DECEMBER 1, 2009?**

5
6 **A.** Yes.

7
8 **Q. PLEASE SUMMARIZE YOUR REPLY TESTIMONY.**

9
10 **A.** In my direct testimony, I showed that excessive intrastate switched access rates hurt
11 consumers and competition. I also showed that an immediate reduction of Arizona
12 ILECs' excessively high intrastate switched access rates to match the corresponding
13 interstate rates (and capping the CLECs' charges at the competing ILECs' levels) is a
14 reasonable, balanced step toward resolving these problems and that reform can be easily
15 implemented. Thus, the evidence is more than sufficient for the Commission to take the
16 moderate action that AT&T has proposed and that Sprint strongly supports. Over 20
17 states have done the same, and just this past month – on January 20, 2010 – the New
18 Jersey Board of Public Utilities announced in a public meeting that it too is requiring
19 reduction of intrastate switched access rates to interstate levels. The Board's order was
20 released on February 1, 2010, and in it the Board requires the first reductions to occur in
21 just 20 days.

22 Some parties in this proceeding, however, have gone to extraordinary lengths to
23 avoid, obscure and confuse one of the main issues in this case – to determine the proper
24 intrastate access rate. **First**, several parties agree that access reform is necessary, but
25 advocate a weak "interim" reform that would not achieve the needed interstate parity.
26 The leading advocate of this approach is Qwest, whose position essentially boils down to
27 the proposition that "access reform is good for everybody else, but not for me." Qwest

1 tries to give itself a blanket exemption from reform by proposing that all carriers *other*
2 than Qwest reduce their intrastate switched access rates to the rates that Qwest charges.
3 Not surprisingly, Verizon, who has asked for the same exemption in those states where it
4 is a large ILEC, agrees with Qwest. What is surprising, however, is that the Arizona
5 Local Exchange Carriers' Association ("ALECA") also supports this position, even
6 though it previously and correctly advocated that intrastate rates should be reduced to
7 parity with interstate rates (exactly as AT&T and Sprint propose here). ALECA does not
8 explain its sudden change. Staff correctly recognizes that the ultimate goal should be
9 equalizing all ILECs' intrastate and interstate switched access charges, and acknowledges
10 the problems associated with the lack of interstate parity, but it joins Qwest and ALECA
11 to recommend a reduction only to Qwest's intrastate rate.

12 Using Qwest's access rate as a target to which other ILECs' intrastate switched
13 access charges are reduced will not serve the best interests of Arizona consumers. It will
14 still leave intrastate switched access rates well above interstate levels, and would exempt
15 the state's largest LEC (and thus, the majority of access traffic) from reform altogether.
16 Moreover, Qwest's approach is not simple, as it will require other carriers to implement
17 new systems and procedures to bill Qwest's rates¹, in contrast to the easy-to-implement
18 AT&T-Sprint proposal, under which carriers would simply use their existing interstate
19 billing procedures, systems and rates for intrastate traffic as well.

20 The purpose of this docket is *not* to preserve historic and increasingly
21 anachronistic access subsidy streams, or to give any one carrier a free pass. Rather, the

¹ The proposal to use Qwest rate as the target will also result in inconsistent intrastate rates for the ALECA members as some will have their rates set below their corresponding interstate level and others will be above interstate.

1 outcome of this proceeding should be to ensure that all Arizona consumers benefit from
2 robust competition among all telecommunications providers. As I explained in my direct
3 testimony, that full measure of competition will not occur so long as IXC's remain
4 burdened with access subsidy (i.e., universal service support) obligations that other firms
5 do not bear. After the long wait for reform, and after all the time, effort, and preliminary
6 proceedings and workshops that were involved in bringing this issue and all LECs before
7 the Commission, it is time to take steps that achieve interstate parity.

8 **Second**, some parties (principally ALECA) have attempted to use this access
9 reform effort to automatically qualify for additional High Cost Support and Lifeline
10 funding. Should the Commission adopt access reform in this proceeding, it should ensure
11 its policy does not enable any carrier's High Cost and Lifeline status quo to change solely
12 because of the implementation of the reform. Any additional request for AUSF support
13 should be reviewed separately on its own merit.

14 **Third**, the CLECs steadfastly ask the Commission to ignore their market power
15 over switched access services and their exorbitant access rates, which are higher than
16 Qwest's intrastate rate and many times higher than their corresponding interstate rates. In
17 this manner, they hope to continue extracting monopoly charges from IXC's and the
18 IXC's' end users. The Commission should reject the CLECs' claims. As the New Jersey
19 BPU recently found, capping CLEC access rates at the CLECs' interstate rate levels is
20 fully warranted because, in the BPU's words, "... LECs have a monopoly over access to
21 their end users" and "... "there is no ability for an IXC or its customers to avoid
22 excessive access charges." In Arizona, as in New Jersey, "there is no evidence that
23 interstate access rates capped by the FCC eight years ago have caused any CLEC to exit

1 the market.” New Jersey BPU Docket TX08090830, *Final Order* dated February 1,
2 2010, at 27.

3 The subsidy system where residential retail prices were intentionally set low,
4 supported by higher access rates, was intended for the ILECs (not the CLECs) in the
5 monopoly era, and that system is no longer sustainable. Some CLECs (e.g. Cox)
6 mistakenly think it was intended for them, and that they should continue to collect
7 excessive access charges in perpetuity.² And even if it was, most of the CLECs
8 participating in this proceeding serve no residential customers, and therefore such high
9 access charges for those CLECs cannot be justified based on the original purpose of the
10 subsidy. The fact is that CLECs’ retail prices have been determined under a more flexible
11 system in Arizona than existed traditionally for the ILECs, their local service rates have
12 not been held to the same low levels as ILECs, and CLECs have been able to choose
13 which geographic areas to enter, allowing them to focus on the most profitable
14 customers. Consequently, there is no sound policy basis to maintain such high intrastate
15 switched access charges for CLECs.

16 Moreover, despite the Joint CLECs’ unsupported claim to the contrary, CLECs do
17 wield market power over switched access services, because the party who makes the
18 decision about who the access provider will be—the CLEC’s end user customer—is not
19 the party who pays for the access—the IXC. As I discussed in my direct testimony, and
20 as the New Jersey BPU recently confirmed, the IXCs have no choice but to use the CLEC
21 chosen by the CLEC’s customers to originate or terminate calls to CLEC end users and,
22 due to price averaging requirements and technological limitations, IXCs cannot charge

² See Garrett Direct at p.4 advocating a delay of access reform in Arizona.

1 the CLEC's customers toll prices that reflect the CLEC's high access charges, and
2 therefore, cannot encourage or force them to make a different choice of access provider
3 who will accept lower access charges. The Commission should not allow CLECs to
4 continue charging higher access rates than those that would be sustained if the IXC's
5 could choose the access provider as in a competitive market, *i.e.*, the rates of the
6 incumbent supplier – the ILEC.³ AT&T's CLEC affiliates, AT&T Communications of
7 the Mountain States, Inc. and TCG Phoenix, stand ready to reduce their intrastate access
8 rates to levels of the ILECs with whom they compete, if so ordered for all CLECs by the
9 Commission. AT&T's proposed caps on intrastate switched access should apply to all
10 CLECs alike so that they are all put on the same competitive footing and allowed to
11 operate on their own merits.

12 The CLECs argument that they have higher costs than the ILECs is not
13 convincing either. As Dr. Aron explains in her accompanying testimony, the level or type
14 of costs CLECs incur does not determine what they could charge in a competitive
15 market—where their prices would be constrained by the ILEC's prices. These carriers –
16 which have access to the most efficient technology, the right to pick and choose where to
17 provide service, and more relaxed retail pricing regulations – should be able to compete
18 effectively for local exchange services, without excessive intrastate access charges, by
19 improving efficiency. They should rely only on their own merits to recoup any lost
20 revenue in the retail market through retail rate increases and improved service offerings.

³ This essentially means that, as a practical matter, the CLECs' Arizona cap will be similar to their interstate levels (should the Commission reduce the ILECs' intrastate prices to mirror interstate) since pursuant to FCC rules the CLECs' interstate rates have been capped at the competing ILEC's interstate rate levels since 2001. However, it does not necessarily mean that all of the other terms and conditions from FCC's capping rules (e.g. the rural exemption) will apply unless the Commission adopts them.

1 If they are unable to do so, they should not be permitted to mask their inefficiencies by
2 imposing excessive intrastate switched access charges on the IXC's and the IXC's
3 customers. It is neither good economic nor regulatory policy to encourage inefficient
4 CLEC operations in Arizona. As I noted in my Direct Testimony, a number of other
5 states already have agreed with that position (New Jersey being the most recent) and have
6 capped CLEC access rates. Indeed, in New Jersey, CLECs offered many of the same cost
7 arguments offered here in Arizona, but the BPU observed that CLEC cost models
8 "grossly overstate[] intrastate switched access costs" by, for example, overstating cost of
9 capital, overheads and depreciation rates, and by including loop costs which, as the BPU
10 succinctly noted, "should not be included" in an access cost study. New Jersey February
11 1, 2010 Final Order at 27.

12 **Finally**, the Residential Utility Consumers' Office ("RUCO") does not advocate a
13 specific proposal for reform, but instead sets forth its suggested guidelines for how to
14 approach the issue. As I will show, AT&T's proposal satisfies all of RUCO's
15 suggestions. It will promote competition to the benefit of Arizona consumers.

16 AT&T's proposal will provide the incumbent local exchange carriers with the
17 opportunity to increase retail revenues to at least partially offset the access revenue
18 reductions, and in limited circumstances, allow them to draw moderately from the AUSF
19 to replace remaining access reductions.

20 Consequently, the Commission should immediately implement long-overdue
21 reforms to intrastate switched access rates, and it should reject any suggestion that reform
22 of all Arizona LECs' intrastate switched access charges be further delayed (as ALECA,
23 Qwest and Verizon have suggested) or "phased in" over a long transition period (as the

1 Joint CLECs have suggested). Any further delays in reform will only favor some carriers
2 at the expense of others, to the detriment of Arizona consumers.

3 **Q. HOW IS YOUR REPLY TESTIMONY ORGANIZED?**

4
5 **A.** In Section II, I expose the flaws in Qwest's and Verizon's "not in my backyard"
6 approach to access reform. I explain that their proposals favor themselves at the expense
7 of other carriers and the public interest.

8 In Section III, I rebut the testimony of ALECA, which piggy-backs on the Qwest
9 proposal. I show that ALECA's recommendation, that LECs' intrastate access rates be
10 reduced to Qwest's intrastate level (an approach that would give Qwest a free pass), is
11 inconsistent the objectives they themselves articulate and with the broader reform
12 ALECA itself has previously advocated. I also explain that additional burden on AUSF
13 would be minimized by adopting AT&T's gradual rebalancing approach which I
14 discussed in my direct testimony, and that AUSF should not be expanded in this docket
15 for allegedly unfunded federal "high cost" needs.

16 Section IV of my testimony refutes the Joint CLECs' implausible and flawed
17 arguments as to why the CLECs should be excluded from access reform. I show that the
18 CLECs should easily handle the access reduction that would result if they cap their
19 intrastate switched access rates at the level of the ILEC in whose service territory they
20 operate. That will essentially be their own corresponding interstate levels if the
21 Commission also adopts AT&T's proposal to reduce the ILECs' intrastate switched
22 access rates to their interstate levels. I explain that the CLECs have operated by charging
23 the same rates for interstate switched access service, which is effectively the same
24 function, since 2001 pursuant to FCC rules.

1 Section V contains my response to Staff's testimony. I explain that Staff's
2 proposal cannot adequately remove the rate disparities that Staff correctly identifies as
3 harmful to efficiency, competition, and Arizona consumers.

4 In Section VI, I explain that AT&T's proposal satisfies RUCO's concern that
5 access reform be balanced and gradual so as not to be harmful to consumers. In Section
6 VII, I provide concluding remarks urging the Commission to take immediate steps to
7 mandate comprehensive access reform for all Arizona LECs.

8 **II. RESPONSES TO THE DIRECT TESTIMONY OF MS. LISA HENSLEY**
9 **HECKERT ON BEHALF OF QWEST AND MR. DON PRICE ON**
10 **BEHALF OF VERIZON**

11 **Q. PLEASE SUMMARIZE THE PROPOSALS OF QWEST AND VERIZON.**

12 A. Qwest supports access reform, except when it comes to Qwest's own access charges.
13 Qwest proposes that the Commission order all *other* LECs to reduce their intrastate
14 switched access rates to match Qwest's intrastate rates, but give Qwest a free pass on
15 access reform. Verizon supports Qwest's proposal.

16 **Q. WOULD QWEST'S PROPOSAL COMPREHENSIVELY REFORM THE**
17 **INTRASTATE SWITCHED ACCESS REGIME FOR ALL PROVIDERS TO**
18 **BENEFIT ARIZONA CONSUMERS?**

19 A. No. Nearly all parties in this case agree that the current subsidy pricing policy is harmful
20 to competition, efficiency, and even to the ILECs and their customers for whom the
21 subsidies were initially created. And as AT&T has explained, only a single
22 comprehensive public policy that applies to *all* carriers equally can effectively eliminate
23 these problems. For starters, Qwest's approach would mean that the Commission would
24 adopt disparate policies for different carriers because some ALECA companies (i.e. those
25 whose interstate switched access charges are higher than the proposed Qwest rate) will

1 reduce their intrastate access charges below the current interstate levels, other ALECA
2 members will end up with new intrastate charges above their interstate levels.⁴ And there
3 would be no change in Qwest's access charges at all, the largest ILEC, which represents
4 the largest share of access minutes in the state.⁵

5 While Qwest has lowered its access charges in Arizona during the last several
6 years, its intrastate switched access charges are still more than double its interstate
7 switched access charges even though both interstate and intrastate switched access
8 services are provided using substantially the same facilities. This disparity distorts and
9 hinders competition in Arizona as I described in my direct testimony. Access reform will
10 not be comprehensive if the largest LEC in Arizona gets a free pass.

11 As I stated in my direct testimony, such disparity makes no sense (because
12 interstate and intrastate switched access services provide virtually the same
13 functionality), creates opportunities for harmful arbitrage (e.g. traffic pumping)⁶, and
14 creates the administrative inefficiencies of having to maintain two separate, very different
15 sets of charges for the same underlying services.⁷

16 The real beneficiary of Qwest's proposal is Qwest. It will save money as other
17 LECs' access charges (most notably the ALECA and CLEC access charges) are reduced,
18 but Qwest itself will continue to collect the exact same, excessive access subsidies that it

⁴ See OAO Reply Exhibit A. In next section, I provide examples of how using Qwest intrastate rate as the target will have disparate impacts on the ALECA members.

⁵ Specifically, in 2008, more than **BEGIN HIGHLY CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL** percent of the total minutes originated and terminated in Arizona, by all LECs involved in this case, traverse Qwest network.

⁶ Traffic pumping schemes include LECs' support for questionable operations such as chat lines used for pornographic or other unsavory purposes. Allowing excessive intrastate high access charges to continue in Arizona will promote the incentives for such activities.

⁷ Even worse is the fact that Qwest proposal has the potential to create greater disparities among the interstate and intrastate charges of the ALECA members. I will discuss this further in the next section.

1 collects today. To a large extent, the impediments to a properly functioning competitive
2 market will remain to harm consumers.

3 Comprehensive access reform is not, and should not be, designed to favor any
4 carrier. It is about the *public* interest and benefits to consumers all over the state. The
5 Commission should not adopt any policy only to favor Qwest at the expense of Arizona
6 consumers who use traditional wireline long distance service, and who have been denied
7 the benefits of full competition because AT&T and other wireline long distance carriers
8 (“interexchange carriers” or “IXCs”) are forced to bear the brunt of the LECs’ access
9 charges, while competing providers using different technologies do not have the same
10 burden. The Commission should adopt AT&T’s approach instead and address the access
11 charge issue now by requiring all Arizona ILECs to reduce their intrastate switched
12 access charges immediately to parity with their interstate charges, and all Arizona CLECs
13 to reduce their switched access charges to the levels of the ILECs with whom they
14 compete. And as I illustrated in my direct testimony, AT&T’s proposal can be achieved
15 with only a 75 cents per line increase in Qwest’s basic retail rate, and without raising any
16 affordability concerns.⁸

17 **Q. VERIZON SUPPORTS QWEST’S PROPOSAL IN ARIZONA. DOES VERIZON**
18 **ALSO SUPPORT THIS APPROACH IN OTHER STATES WHERE VERIZON IS**
19 **NOT AN ILEC?**

20 **A.** Not at all. Although Verizon has suggested Qwest’s average switched access charge of
21 2.2 cents per minute is a good benchmark for access reform in Arizona, Verizon has
22 advocated rates that are much lower, sometimes advocating interstate switched access

⁸ See Dr. Oyefusi Direct at page 62 (Table 1). With a 75 cents per line increase by Qwest, its residential monthly retail rates would become \$13.93 per line which is significantly below the retail rate benchmark level of \$16.48 that Qwest itself suggests. See Copeland Direct at page 6.

1 rates, in other states in cases that involved non-major ILECs other than Verizon or Qwest.
2 For example, in 2007, several Verizon affiliates filed a complaint before the Public
3 Utilities Commission of Ohio (“PUCO”) against CenturyTel and Windstream, two ILECs
4 whose intrastate access charges were ten or more times greater than those of AT&T Ohio,
5 the RBOC serving that state.⁹ Verizon’s Ohio complaint urgently contended that
6 allowing the defendants’ intrastate access charges to remain so high:

7 hurts the state’s economy, and the development of the telecommunications
8 industry, because more efficient competition and the consumer benefits it yields
9 cannot be achieved as long as carriers seek to recover a disproportionate share of
10 their costs from other carriers, rather than from end users. Such irrational access
11 rate structures “lead to inefficient and undesirable economic behavior.”¹⁰
12

13 Notably, the relief Verizon Ohio sought in that case is the same relief AT&T seeks (and
14 Verizon opposes) here – a reduction in the defendants’ intrastate access charges to
15 interstate levels. Verizon Ohio argued that the Ohio commission should lower the Ohio
16 LECs’ rates to match those of AT&T Ohio (less than 1 cent per minute, which was
17 AT&T Ohio’s interstate rate) or, “[i]f the Commission is reluctant to move CenturyTel
18 and Windstream immediately to the same rate as other large carriers, a reasonable interim
19 solution would be to require CenturyTel and Windstream to *mirror their own interstate*
20 *rates.*”¹¹ Thus, Verizon Ohio demanded that the defendant ILECs’ intrastate access
21 charges be reduced *immediately* from several cents per minute to less than 1 cent per
22 minute, an average rate significantly less than the Qwest rate of 2.2 cents Verizon has
23 proposed here.

⁹ *Verizon North, Inc. et al. v. CenturyTel of Ohio et al.* Case No. 07-1100-TP-C88, filed October 5, 2007 (“Verizon Ohio Complaint”), at ¶ 12.

¹⁰ Verizon Ohio Complaint, ¶ 21 (citation omitted).

¹¹ *Id.* ¶ 30 (emphasis added).

1 Likewise, in 2008, Verizon NW filed a complaint in Washington to reduce
2 Embarq's (now CenturyLink's) intrastate switched access charges because "excessive
3 switched access rates distort the playing field."¹² Verizon NW's prayer for relief sought
4 an order capping CenturyLink's intrastate switched access charges at Verizon NW's
5 level, which is, on average, less than 1 cent per minute,¹³ again a rate much lower than
6 the Qwest rate Verizon has proposed in this case.

7 Similarly, in July 2009 Verizon filed comments in Wisconsin on CenturyTel of
8 the Midwest-Kendall's ("CenturyTel's") application for an alternative regulation plan. In
9 its comments, Verizon Wisconsin sought "long overdue" reductions in CenturyTel's
10 switched access charges,¹⁴ and it argued that "it is not in the public interest to require
11 Verizon and other carriers and their long-distance customers to continue subsidizing
12 CenturyTel *for one moment longer*."¹⁵ Verizon again suggested that *interstate parity*
13 would be acceptable:

14 If the Commission declines to adopt Verizon's proposal to benchmark
15 CenturyTel's [intrastate switched] access rates to AT&T's [the state RBOC], then
16 it should approve Staff's Option 2b to reduce CenturyTel's access rates to parity

¹² *Verizon Select Services, Inc., et al. v. United Telephone Company of the Northwest*, Complaint to Reduce Intrastate Switched Access Charges, Washington Utilities and Transportation Commission, Docket No. UT-081393, filed July 25, 2008 ("Verizon Washington Access Complaint") at ¶ 18.

¹³ Verizon NW's local switching rate is \$0.0158172 for originating traffic and \$0.0014151 for terminating traffic. *Id.* ¶ 22. The complaint also notes that Embarq's interstate switched rate is below Verizon's intrastate rate. *Id.* ¶ 37.

¹⁴ Verizon's Comments and Request for Hearing, *Application of CenturyTel of the Midwest-Kendall, LLC for Approval of an Alternative regulation Plan*, Docket No. 2815-TI-105 (Verizon Wisconsin Comments), Sprint exhibit Sprint-23, at p. 1.

¹⁵ *Id.* at p. 2. (emphasis added)

1 with its own interstate rates . . . begin[ning] when CenturyTel's Existing Plan
2 expires in September [2009].¹⁶
3

4 However, the Qwest intrastate rate of 2.2 cent per minute which Verizon has endorsed in
5 this case contains the very same subsidies which Verizon complained should be removed
6 from CenturyTel's intrastate switched access charges, and it is not at parity with Qwest's
7 interstate rate.

8 **Q. WHY WOULD VERIZON SUPPORT QWEST'S PROPOSAL, GIVEN THAT IT**
9 **WOULD HAVE TO REDUCE ITS OWN ARIZONA ACCESS CHARGES TO**
10 **MATCH THOSE OF QWEST?**

11 A. In those states where Verizon is the largest ILEC – and where Verizon has much more
12 access volume and revenue at stake than it does in Arizona – Verizon advocates the same
13 “not in my back yard” approach that Qwest does here. So Verizon seems willing to
14 support a policy reducing its rate to the Qwest target in Arizona (where its volumes and
15 revenues are lower and its financial exposure is much smaller) so that it can appear
16 consistent when it suggests the same free pass for itself in those other states. In New
17 Jersey, where Verizon offered the same arguments Qwest is making here, the BPU
18 rejected the Verizon position and directed Verizon, along with all other New Jersey
19 LECs, to reduce its intrastate access rates to parity with its interstate rates – i.e., the same
20 result AT&T is recommending here.

21 **Q. MAINTAINING HIGH ACCESS CHARGES WOULD BENEFIT QWEST'S AND**
22 **VERIZON'S SELF-INTEREST, BUT WOULDN'T A REDUCTION IN ACCESS**
23 **CHARGES BENEFIT AT&T'S SELF-INTEREST?**
24

25 A. There is a very important difference. Qwest and Verizon want to make other carriers'
26 consumers keep paying subsidies to them. By contrast, AT&T is not asking the

¹⁶ *Id.* at p. 5. Staff's Option 2b called for a 2-step reduction to the intrastate rate that would not become effective until February 1, 2012 and 2013. *Id.* at p. 9.

1 Commission or any other carrier for an artificial regulatory handout. To the contrary,
2 AT&T is simply asking the Commission to *reduce* an artificial regulatory burden that
3 AT&T – and its retail customers – have been forced to pay for far too long. That result
4 will only provide AT&T the opportunity to compete on its own *merits* and take its
5 chances in the market, just as businesses are supposed to do.

6
7 **III. RESPONSE TO THE DIRECT TESTIMONY OF MR. DOUGLAS**
8 **DUNCAN MEREDITH ON BEHALF OF ALECA**

9 **a. ALECA's Testimony Contains Policy Arguments Inconsistent with its**
10 **Previous Positions.**

11 **Q. HOW DOES ALECA'S PROPOSAL TO USE QWEST'S INTRASTATE**
12 **CHARGES AS THE TARGET FOR ALL LECS COMPARE TO ITS PREVIOUS**
13 **POSITIONS?**

14 **A.** ALECA's recent endorsement of Qwest's proposal is a dramatic and unexplained
15 reversal from its previous position. In a White Paper dated November 2, 2006, ALECA
16 correctly recognized that due to technological and competitive developments, and the
17 series of reforms the FCC had implemented for interstate switched access, the rate
18 disparities that exist between its members' interstate access rates and their Arizona
19 intrastate access rates have created an unstable business environment.¹⁷ ALECA
20 expressed concern that its "members' financial survival depends on access charges"¹⁸
21 and decried the fact that lack of parity with interstate access rates disadvantaged its
22 *members* and their *customers*, and also criticized the unhealthy arbitrages made possible
23 by such disparities. ALECA agreed with the Montana Telecommunications Association

¹⁷ See whitepaper titled "The Case for Arizona Access Charge Reform," by the Arizona Local Exchange Carrier Association (ALECA), dated November 2, 2006.

¹⁸ Id.

1 that "the differences in intrastate and interstate access charges can no longer be sustained
2 in a competitive environment, especially where technology has enabled telephone calls to
3 circumvent access charges altogether...." ALECA then called for immediate action¹⁹ to
4 reduce its members' intrastate switched access charges to the corresponding interstate
5 levels (which is the same solution AT&T has recommended in this case).

6 ALECA's direct testimony in this case enumerates some of the same points, facts,
7 history, and the problems of rate disparities, and expresses the same urgency for intrastate
8 access reform in Arizona. However, ALECA now proposes a very different solution:
9 that its members' intrastate access rates should only be reduced to match Qwest's
10 intrastate switched access rate level.²⁰ This represents a major change from ALECA's
11 previous White Paper, and from its discovery responses in this case, where ALECA
12 advocated that intrastate rates be reduced to parity with interstate rates.²¹ Moreover,
13 ALECA itself acknowledges that its current proposal would not achieve comprehensive
14 reform of Arizona intrastate switched access but is only a step toward access reform.
15 Such incomplete steps are contrary to ALECA's previous recognition that immediate
16 action is needed to achieve full interstate parity.²²

¹⁹ Id. at p.7.

²⁰ See Meredith Direct at p.7.

²¹ See ALECA White Paper at pp. 2-3.

²² Recently in May 2009, in response to Staff's discovery question ALECA still maintained that it believes "... unifying the intrastate and interstate access rates and rate structures is the appropriate action to take," as AT&T proposes here. ALECA opposed then the same proposal it now advocates by explaining further that "...moving to Qwest's intrastate rates would not address rate arbitrage encouraged by an individual company's variance between intrastate and interstate access rates." See also ALECA's responses to Staff DR 1.10.

1 **Q. WOULD ADOPTING THE QWEST PROPOSAL, AS ALECA NOW SUGGESTS,**
2 **BRING COMPREHENSIVE REFORM AND ACHIEVE FULL INTERSTATE**
3 **PARITY?**

4
5 A. No, as I explained in Section II above in rebutting Qwest's testimony. Not surprisingly,
6 then, ALECA fails to explain how its proposal will eliminate the interstate-intrastate rate
7 disparities (because it will not) and, more importantly, how its proposal will eliminate all
8 the problems that result from such disparities as ALECA itself previously recognized
9 (because it will not). The host of problems identified by ALECA and other parties,
10 including AT&T, will continue to exist and harm consumers, ALECA members, and the
11 IXC's if the Commission adopts ALECA's new proposal.

12 **Q. HOW DOES ALECA ATTEMPT TO JUSTIFY ITS NEW-FOUND SUPPORT**
13 **FOR QWEST'S PROPOSAL?**

14 A. ALECA claims that (i) adopting Qwest's intrastate charges as a benchmark would
15 promote equity between urban/suburban and rural areas of the state, (ii) Qwest's charges
16 are "publicly available, and it provides a simple and straightforward target rate for
17 switched access reform," and (iii) that adopting Qwest's intrastate charges instead of
18 achieving parity with ALECA's interstate levels will lessen the burden on the AUSF.²³

19 **Q. HOW DO YOU RESPOND TO ALECA'S ARGUMENT THAT USING QWEST'S**
20 **INTRASTATE CHARGES WILL PROMOTE "EQUITY" BETWEEN**
21 **INTRASTATE SWITCHED ACCESS CHARGES IN URBAN AND RURAL**
22 **AREAS?**

23 A. In testimony, ALECA failed to explain exactly why intrastate switched access charges
24 must be the same between distinct geographic areas or whether there is any economic or
25 public policy support for insisting that such outcome must be achieved. In fact, ALECA
26 has never previously said the difference in intrastate switched access charges between

²³ See Meredith Direct at page 7.

1 geographic areas (which represent distinct and unrelated markets) was any problem.²⁴

2 More importantly, ALECA has itself recognized that the real “inequity” is the present
3 disparity between interstate and intrastate switched access charges within the *same*
4 geographic area and for functionally the *same* services offered by the *same* LEC, and that
5 this has caused serious competitive distortions and arbitrage opportunities.

6 Moreover, ALECA’s adoption of the Qwest proposal would still leave disparities
7 between interstate and intrastate switched access charges, and ALECA has not, and
8 cannot, establish that there are any functional differences between interstate and intrastate
9 switched access services to justify allowing such rate disparities to continue. Therefore,
10 ALECA’s new proposal in this case is flawed and unsupported. According to ALECA’s
11 own calculation, Qwest’s statewide composite intrastate switched access charge of 2.2
12 cents per minute (which would become the ALECA members’ intrastate charge if
13 Qwest’s proposal is adopted) is higher than the ALECA members’ composite interstate
14 charge, which is only 1.66 cents per minute.²⁵ Thus, if the Commission adopts Qwest’s
15 proposal, as ALECA now suggests, the ALECA members’ intrastate charges will still be
16 **BEGIN HIGHLY CONFIDENTIAL [REDACTED] END HIGHLY CONFIDENTIAL**
17 higher on average than the ALECA members’ corresponding interstate charges for the
18 exact same access services. That is hardly an adequate solution to the interstate-intrastate

²⁴ For example, the three Frontier companies serve three distinct and unrelated service territories in Arizona, and each is also different from the service territories of any other ALECA member in the state. There are no economic reasons to expect that prices will align across different markets that obviously have different characteristics, nor would that outcome yield any public interest benefits. A single policy that requires a carrier to charge the same price within its own service area for services that are functionally the same is superior to any attempt to artificially force intrastate access rates to align across different geographic markets.

²⁵ See Meredith Direct at p. 7.

1 rate disparities that ALECA correctly recognized were a threat to its members and to
2 consumers.

3 As I discussed earlier, this proposal would also create unintended complexities and
4 inconsistent results for companies within the same association, and the Commission must
5 be aware of these. The ALECA membership consists of eleven (11) independent local
6 exchange carriers (LEC) operating in Arizona,²⁶ plus three tribal companies²⁷ that serve
7 different geographic areas or markets in Arizona, and each has different interstate and
8 intrastate charges. Therefore, lumping these companies together and discussing their
9 charges as an average or essentially treating them like one single company is misleading.
10 Actually, the current intrastate switched access charges of ALECA members range from
11 about **BEGIN CONFIDENTIAL** [REDACTED] **END CONFIDENTIAL** cents per minute,
12 and their interstate charges range from about 1.4 to 4.3 cents per minute.²⁸ And as OAO
13 Reply Exhibit A shows, adopting Qwest's intrastate switched access rate as the target to
14 which the ALECA members' intrastate charges should be reduced would cause
15 circumstances where most members' charges will fall below their interstate levels and the
16 three Frontier companies²⁹ will still maintain intrastate charges above their corresponding

²⁶ According to ALECA White Paper, the membership includes: Accipiter Communications, Arizona Telephone Co., Citizens Utilities Rural, Copper Valley Telephone, CTC White Mountains, Midvale Telephone Exchange, Inc., Navajo Communications Company, South Central Utah Telephone Association, Southwestern Arizona Tel., Table Top Telephone Company, Inc. and Valley Telephone Cooperative, Inc..

²⁷ According to ALECA White Paper, the ALECA tribal members are: Fort Mojave Telephone Company, San Carlos Apache Telecom Utility, Inc., and Tohono O'Odham Utility Authority.

²⁸ See OAO Reply Exhibit A. The average interstate rates charged by each ALECA company are based on their 2009 annual filing at the FCC. ALECA has refused to provide actual disaggregated interstate data for each of its members when asked in discovery. See ALECA Response to AT&T 2.12.

²⁹ The three Frontier companies are: Citizens Telephone Company White Mountains, Navajo Communications Company, Citizens Utilities Rural.

1 interstate levels.³⁰ For example, the impact on Frontier is that after the reform to Qwest
2 target rate its intrastate switched access charges remain up to **BEGIN CONFIDENTIAL**
3 **END CONFIDENTIAL** percent higher than its corresponding interstate
4 charges in two of its three study areas, and all the other ALECA members will have their
5 intrastate switched access charges reduced to **BEGIN CONFIDENTIAL** **END CONFIDENTIAL**
6 percent below their corresponding interstate levels.³¹ The
7 Commission should not adopt a public policy that maintains the disparities between
8 interstate and intrastate access charges which ALECA has admitted will cause peril for its
9 members and their customers.³²

10 **Q. WHY WOULD AT&T OBJECT IF A MAJORITY OF ALECA MEMBERS**
11 **CHARGED ACCESS RATES LOWER THAN THOSE PROPOSED BY AT&T?**

12 A. It is true that ALECA's proposal would result in AT&T paying lower access fees to
13 ALECA members (except Frontier) than AT&T proposes. AT&T objects to ALECA's
14 proposal, however, because it would make bad policy, and AT&T is not looking to
15 benefit from any bad policy. ALECA's new proposal will maintain disparities between
16 interstate and intrastate access charges, with all the attendant problems discussed earlier.
17 In contrast, ALECA's original proposal (in its White Paper and response to Staff data
18 request) to lower intrastate access charges to interstate levels avoids these problems.

³⁰ Another related problem is that the ALECA has not properly articulated whether the policy it has proposed here should be treated as an ongoing cap such that when the Commission reduces Qwest's rate in any future proceeding the ALECA members must also reduce their rates. If that was not the ALECA's intent, then the purpose of aligning the ALECA members' rates with Qwest's rate is questionable and unreasonable. Even if that was the intent, in the interim the ALECA must convince the Commission why it should adopt inconsistent policies where some ALECA members' rates are pegged below the level proposed by AT&T (i.e. their corresponding interstate rates and rate structure), and why others should have their rates set above that level.

³¹ Forcing these ALECA members' rates below their interstate levels will cause them to lose more access revenues (by as much as **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** percent of their annual switched access revenue) than AT&T proposes.

³² See ALECA white paper at pp. 2-3.

1 **Q. WHAT ABOUT ALECA'S ARGUMENT THAT QWEST'S INTRASTATE RATE**
2 **IS PUBLICLY AVAILABLE?**

3 A. ALECA goes nowhere in arguing that the Qwest intrastate switched access charges are
4 publicly available. The ALECA members' interstate switched access charges are also
5 publicly available at the FCC. Moreover, it would be much easier for the ALECA
6 members to match their own interstate rates (as AT&T and Sprint propose, and as
7 ALECA itself proposed in the past) than to match Qwest's intrastate rates. The ALECA
8 members already have tariffs, billing systems and procedures in place to bill their own
9 interstate switched access charges, so they can simply apply the same tariffs, systems,
10 and procedures to intrastate access. By contrast, the ALECA members would have to
11 modify their billing systems and procedures to match Qwest's intrastate switched access
12 rates and structure.

13 **Q. PLEASE RESPOND TO ALECA'S THIRD AND FINAL ARGUMENT, THAT**
14 **THE QWEST PROPOSAL WOULD LESSEN THE BURDEN ON THE AUSF.**

15 A. ALECA's claim that adopting the Qwest rate instead of ALECA interstate rates as the
16 benchmark for access reform will lessen the AUSF support burden is not necessarily true.
17 AT&T's proposal would require AUSF support less than one percent of total
18 telecommunications retail revenue in Arizona.³³ In comparison, ALECA proposal will
19 require AUSF support that equals 1.2 percent of Arizona's total telecommunications
20 retail revenue. Thus, ALECA's proposal will not reduce the overall burden on the
21 AUSF, it will increase the burden.³⁴

³³ See Dr. Oyefusi Direct at pages 58 to 59 (Figure 4 & Figure 5). The amount of support needed for access reform is minimized if the Commission adopts higher benchmark level at or below which carriers will set their retail rates.

³⁴ ALECA suggests that a total of \$32 million should be drawn by its members as AUSF support, i.e. \$23 million to replace the forgone revenue from access reform, plus an additional \$9 million (completely unrelated to access reform) allegedly to fill a gap in the Federal "high cost" funding for the ALECA members.

1 Moreover, the overall burden on *consumers* will be much higher under the Qwest-
2 ALECA proposal, because access charges will still remain at unreasonably high levels for
3 Qwest, Verizon, CLECs, and the three Frontier companies, and the rate disparities
4 between interstate and intrastate switched access rates would remain. In contrast, under
5 AT&T's proposal all interstate-intrastate rate disparities will be eliminated for all
6 carriers, consumers get *more* relief, and the burden on AUSF is less.³⁵
7

8 **b. The Commission Should Not Allow Carriers to Use Access Reform As**
9 **Automatic Qualification Criteria for Additional High Cost and**
10 **Lifeline Funding**

11 **Q. SHOULD THE COMMISSION ADOPT ALECA'S SUGGESTION TO EXPAND**
12 **THE AUSF TO CLOSE AN ASSERTED "GAP" IN FEDERAL HIGH COST**
13 **FUNDING AND TO FUND CENTRAL ADMINISTRATION OF LIFELINE AND**
14 **LINKUP?**

15 **A. No.** Revenue neutral access replacement should not automatically qualify any LEC to
16 receive high cost funding if that carrier's circumstances would not otherwise warrant
17 such support. Of course, implementing access rate reductions in a revenue-neutral
18 manner requires some modifications to the AUSF, as I have described in my direct
19 testimony. But it is improper for parties to use this proceeding as an opportunity to ask
20 for additional AUSF funds without adequately explaining how they merit the additional
21 support. ALECA's suggestion amounts to this: if the Commission reforms the ALECA
22 members' intrastate switched access rates it should also allow its members to draw the
23 state's high cost support to fill a gap in the Federal High cost funding system. But
24 ALECA fails to explain how the proposed access reform would have caused those

³⁵ Even though the AT&T proposal calls for limited, perhaps gradual, retail price increases to rebalance part of the access revenue losses, the additional consumer welfare benefits we discussed in our direct testimonies will offset any impact on consumers, and the net effect will be positive.

1 members' High Cost status quo to change. The position posited by ALECA is wrong,
2 and it will allow ALECA to receive more AUSF dollars (should the Commission agree
3 that its members should draw full access replacement from AUSF) than the forgone
4 access revenue.³⁶ ALECA should be required to justify its High Cost Support requests
5 separately such that carriers receiving High Cost Support under the current system
6 (without access reform) will continue to receive the same support, and carriers that do not
7 currently receive High Cost support will not begin to do so solely because of access
8 reform.

9 Likewise, access reform should be separated from Lifeline and Link-up, such that
10 it does not disturb availability of, eligibility for, and the retail rates charged for Lifeline
11 and Link-up. As Staff comprehensively discussed, there is already a funded process
12 explained in an industry report on this subject, and that option should be explored first,³⁷
13 and should additional support be needed the Commission could consider such proposal
14 on its own merit.

15 **IV. THE COMMISSION SHOULD REJECT THE CLECS' ATTEMPTS**
16 **TO OBTAIN PREFERENTIAL TREATMENT.**

17 **a. CLECs Should Not be Excluded from Access Reform**

18 **Q. IS THERE ANY MERIT TO THE JOINT CLECS' POSITION THAT THEY**
19 **SHOULD BE EXCUSED FROM ACCESS REFORM?**

20 **A.** Absolutely none. Like Qwest, the Joint CLECs take the position that *other* LECs rates
21 should be reduced while the CLECs themselves would be allowed to avoid access reform.

22 They argue that their switched access rates should not be regulated like the ILECs, that

³⁶ According to its own numbers, ALECA's suggestion would give ALECA members additional subsidies to the tune of \$9 million on top of the \$23 million additional AUSF support that ALECA seeks to cover access revenue reductions. See Meredith Direct at p.11.

³⁷ See Shand Direct at pages 23 to 26.

1 rural LECs should be reformed first, and that the CLECs' reform should either wait for
2 the FCC or take up to ten years. However, as demonstrated above, and in AT&T's direct
3 testimonies, excessively high intrastate switched access charges of *all* LECs harm
4 consumers by artificially increasing the wholesale cost (and thus the retail price) of long-
5 distance service. These LECs' high access charges also burden wireline IXC's with an
6 unfair competitive disadvantage vis-a-vis other long distance technologies, which
7 prevents consumers from realizing the benefits of full and fair competition. In sum, high
8 access charges hurt consumers and competition no matter which LEC charges them, and
9 that applies to CLECs as much as it applies to large ILECs and rural ILECs.

10 If anything, the case for reform applies with even more force to CLECs, because
11 the monopoly-era use of access charges to provide implicit subsidy for local exchange
12 rates was *never meant* for new entrants such as CLECs. Unlike incumbent LECs, CLECs
13 need not serve all customers, nor were they ever required to provide universal service to
14 high-cost residential customers. Rather, CLECs serve whom they want, where they want,
15 when they want, and their prices have been determined under a more flexible system in
16 Arizona than existed traditionally for the ILECs. Thus, for the CLECs, high access
17 charges are a mere handout – money doled out with no corresponding social policy *quid*
18 *pro quo*.

19 These handouts create obvious and untenable results. Based on information
20 received in discovery responses, CLECs in Arizona generally charge more than Qwest's
21 excessive intrastate switched access charges. For example, all three Integra companies in
22 this case (Electric Lightwave, LLC, Mountain Telecommunications, Eschelon Telecom)
23 have higher average intrastate switched access charges than Qwest, by at least **BEGIN**

1 **HIGHLY CONFIDENTIAL** ■ **END HIGHLY CONFIDENTIAL** percent.³⁸ Cox's
2 intrastate switched access rate is also higher than Qwest's rate by more than **BEGIN**
3 **HIGHLY CONFIDENTIAL** ■ **END HIGHLY CONFIDENTIAL** percent.³⁹ On
4 average, the Joint CLECs' composite intrastate rates are over **BEGIN HIGHLY**
5 **CONFIDENTIAL** ■ **END HIGHLY CONFIDENTIAL** percent higher than the
6 Qwest's rate.⁴⁰

7 Despite the CLECs' very high access charges, most of the CLECs participating in
8 this proceeding do not serve residential customers in high-cost areas, or for that matter
9 anywhere in this State. According to discovery responses, Cox and MCImetro are the
10 only CLECs that serve any residential customers at all. Instead, the CLECs serve
11 mostly business customers, which historically have been a *source* of support, not the
12 recipients of support (in other words, business customers have paid *higher* retail prices
13 than residential customers). Thus, the historical reasons underlying the adoption of high
14 access charges do not apply to these carriers. Therefore, access reform should apply not
15 only to the ILECs' intrastate access charges, but also to the CLECs' rates as well – at
16 least on the same schedule, if not sooner.

³⁸ Based on data provided by Qwest and Integra response to data request No. STF 1.1.

³⁹ Based on data provided by Qwest and Cox response to data request No. STF 1.1.

⁴⁰ See responses of Eschelon Telecom of Arizona, Inc., Mountain Telecommunications Inc., Electric Lightwave, LLC and McLeod USA Telecommunications Services, Inc. dba PAETEC Business Services, TW Telecom of Arizona, LLC, and XO Communications Services, Inc. ("Joint CLECs") to Staff's data request No STF 1.1. Time appears to have erroneously calculated the average rate it presented to Staff. I have recalculated and used the corrected figure in this analysis.

1 **Q. SHOULD THE CLECS BE PROVIDED PREFERENTIAL TREATMENT AS**
2 **SUGGESTED BY RUCO'S WITNESS DR. BEN JOHNSON WHEN HE STATES**
3 **THAT "THE POLICY CHANGES BEING ADVOCATED IN THIS CASE WON'T**
4 **NECESSARILY HELP NEW ENTRANTS GAIN A FOOTHOLD IN THE**
5 **MARKET"?⁴¹**

6 A. No. The CLECs have been in the telecommunications business for a long time, and they
7 now need to rely on their own strengths as competitors.⁴² They do not need excessive
8 access charges to survive or "gain a foothold." First, on the interstate side CLECs have
9 been limited for years by FCC-ordered "caps" that prevent them from charging interstate
10 access rates that are higher than the rates of the ILECs in whose territories they compete,
11 *i.e.*, as the same principle AT&T proposes for Arizona. The CLECs have operated in the
12 interstate jurisdiction with caps developed on that basis, and there is no reason they
13 cannot operate the same way in the intrastate jurisdiction.⁴³

14 Second, the Joint CLECs are all large, multi-state corporations with very
15 substantial revenues ranging from Integra Telecom, which is comprised of Eschelon
16 Telecommunications, Mountain Telecommunications, Electric Lightwave, Advanced
17 Telecommunications, (\$0.7 billion revenue in 2008) to XO (\$1.5 billion revenue in 2008)
18 to PAETEC (\$1.6 billion). Other CLECs who have not combined with the Joint CLECs
19 in this case also have significant revenue strength: e.g. Level 3 (\$4.3 billion) and Cox
20 (\$15 billion).⁴⁴ Clearly, these are not "mom-and-pop" stores that need handouts to
21 survive. Indeed, no Joint CLEC was able to convincingly support any claim that it's no

⁴¹ See Dr. Johnson Direct at page 25.

⁴² It is past time to remove the training wheels, and either the CLECs have learned how to ride or they should get off the proverbial "bike."

⁴³ For all the CLECs in this case, on average, the interstate traffic constitutes more than 80 percent of the total switched access minutes that traverse their network and these are assessed at the lower interstate rate pursuant to the FCC capping. The CLECs have operated under the FCC's pricing regime with respect to interstate switched access since 2001, and no calamity has befallen them.

⁴⁴ See OAO Reply Exhibit B.

1 longer able to compete or that it had ceased providing service in any state simply because
2 it was required to reduce intrastate access charges.⁴⁵ As the New Jersey BPU recently
3 noted, “. . . there is no evidence that interstate access rates capped by the FCC eight years
4 ago have caused any CLEC to exit the market.” New Jersey BPU February 1, 2010 *Final*
5 *Order* at 27. Nor has any CLEC provided credible evidence that it would be unable to
6 remain in business or that its service would be impaired in Arizona if its intrastate access
7 charges were reduced to not exceed the rates charged by the ILECs with whom it
8 competes.

9 As with Qwest, the Commission should not give CLECs a free pass on access
10 reform. It should instead adopt AT&T’s straightforward proposal that *all* ILECs be
11 required to reduce their intrastate switched access charge to parity with their interstate
12 rates, and at the same time the CLECs’ intrastate charges should be capped at the levels
13 of the ILECs with whom they compete.

14 **Q. DO YOU AGREE WITH THE JOINT CLECS’ ARGUMENT THAT THE**
15 **“CARRIER COMMON LINE CHARGE” SHOULD BE MAINTAINED?⁴⁶**
16

17 **A.** Not at all. The “carrier common line charge” is an access rate element that has absolutely
18 no relationship to access cost, rather its original purpose was to help subsidize the cost of
19 the local loop. The Joint CLECs’ attempt to maintain that revenue stream is completely
20 flawed both as a matter of economics and as a matter of network operations. It is
21 indisputable that the loop is a major part of local exchange service, and that loop costs are
22 a major component of the costs of basic local service. But as the New Jersey BPU
23 concluded, loop costs “. . . should not be included” in any determination of access costs.

⁴⁵ See, e.g., Joint CLECs’ response to AT&T Data Request No. ATT 1-9.

⁴⁶ See Denney Direct at pages 61 to 62.

1 Rather, the cost of the loop is caused by the local service user, and it is the same whether
2 the end user makes a million long distance calls or none. For nearly 20 years, parties that
3 have collected these charges and consumer advocates aiming to keep residential retail
4 rates at exceedingly low levels have repeated the same response, suggesting that some
5 arbitrary portion of local loop costs should be removed from local service cost
6 development and assigned to access or other services. Historically, switched access
7 charges were inflated to subsidize local loop costs as part of the basic *quid pro quo* of the
8 monopoly era (to subsidize below-cost local service for universal service goals), but that
9 is no reason to forget or confuse where loop costs actually belong. The local loop is the
10 transmission line between the end user and the local switch, and the party making the
11 decision about whether to have the line available to them for any service is the end user
12 (the LEC's customer).⁴⁷ Loop costs are not usage sensitive because they are the same
13 regardless of the amount of local or long distance usage. Hence, the pricing regulation
14 that recovers the loop costs from flat-rated retail prices, rather than usage sensitive
15 switched access charges, will encourage efficient decision making by the end-user
16 consumer. The retail prices should be imposed on the end-user consumer making the
17 purchasing decision to install a loop. And it should be imposed by the local exchange
18 company that incurs the building costs. Taken together, these cost causation principles
19 require loop costs to be recovered by the local exchange company, and only the local
20 exchange company, as a flat-rated price.⁴⁸ Hence, for the same reasons that implicit

⁴⁷ The driver of the cost of a loop is the triggering event – placing an order for local service. The loop is built for the purpose of providing local service.

⁴⁸ That, however, is not the purpose of the instant proceeding since no party has presented a cost study that needed to be reviewed or where the loop cost will require some allocation. Also, no one has suggested that the LECs' prices be set at cost, therefore the Joint CLECs' discussions about NTS or cost allocation which is only germane when reviewing cost studies are irrelevant.

1 subsidies should be reduced (as I explained in my direct testimony) there is no
2 justification for continuing to assess the CCL as a part of intrastate switched access rate
3 structure.⁴⁹

4 **Q. THE JOINT CLECS CLAIM THAT AT&T'S IN-STATE CONNECTION FEE**
5 **DOES NOT VARY ACROSS STATES WITH DIFFERENT INTRASTATE**
6 **ACCESS RATES.⁵⁰ PLEASE RESPOND.**

7 A. The Joint CLECs are trying to create confusion about a very simple commitment that
8 AT&T has made and that I presented in my direct testimony. As I explained there, *when*
9 all Arizona LECs' intrastate switched access rates are reduced to interstate levels, AT&T
10 will (1) eliminate entirely its \$1.49 per line in-State Connection Fee ("ISCF") currently
11 applicable to stand-alone long distance customers, and (2) reduce in-state rates for its
12 prepaid calling cards.⁵¹

13
14 **b. The CLECs' Arguments Should be Viewed for What They Are: To**
15 **Confuse and Distract.**

16 **Q. WHAT OTHER ARGUMENTS DID THE JOINT CLECS MAKE?**

17 A. The remainder of the CLEC testimony consists of irrelevant proposals that are completely
18 out of the scope of the instant docket and are apparently designed to distract the
19 Commission from access reform. First, the Joint CLECs suggest that the Commission
20 should modify the rates paid by wireless carriers for intraMTA Traffic. This matter is not
21 before the Commission in this proceeding, nor should it be. The FCC has established the

⁴⁹ The FCC has made the same conclusion in its series of access reforms in the past thirteen (13) years. See, e.g., FCC's CC Docket No. 96-262, 94-1, 91-213, 95-72, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges (First Report and Order released May 16, 1997), ¶ 36-37.

⁵⁰ See Denney Direct at pages 64 to 65.

⁵¹ See Direct Testimony of Dr. Oyefusi at page 42.

1 MTA rule which holds that intraMTA traffic is subject to *reciprocal compensation*,⁵² not
2 access charges. As I have explained earlier, this Arizona proceeding is about the
3 determination of the appropriate rates for *intrastate switched access service*. Therefore,
4 pricing of intraMTA traffic is not at issue in this proceeding and, hence, Mr. Denney's
5 references to matters involving determination of North County Communications'
6 intraMTA rates, or intraMTA rates in general, are outside the scope of this docket.⁵³
7 Also, Mr. Denney's suggestion to set intrastate, intraMTA terminating rates at the
8 CLECs' intrastate switched access rate is wrong.⁵⁴ The proper way to reduce the
9 competitive distortions between wireline and wireless long distance services is not to
10 raise a cost-based rate (like intraMTA rate) to a legacy subsidy rate (such as intrastate
11 switched access charges), but to decrease the subsidy rate toward the cost-based one. The
12 Commission should disregard the Joint CLECs' proposal.

⁵² In the *Local Competition First Report and Order*, the Commission stated that traffic to or from a CMRS network that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations under section 251(b)(5), rather than interstate or intrastate access charges. The Commission reasoned that, because wireless license territories are federally authorized and vary in size, the largest FCC-authorized wireless license territory, *i.e.*, the MTA, would be the most appropriate local service area for CMRS traffic for purposes of reciprocal compensation under section 251(b)(5). Thus, section 51.701(b)(2) of the Commission's rules defines telecommunications traffic exchanged between a LEC and a CMRS provider that is subject to reciprocal compensation as traffic "that, at the beginning of the call, originates and terminates within the same Major Trading Area." *Re Developing a Unified Inter-carrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, FCC Rcd. At 4685, para. 134 (2005); see also 47 C.F.R. § 51.701(b)(2); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, First Report and Order, 11 FCC Rcd at 16014, para. 1036 (1996) (*Local Competition First Report and Order*).

⁵³ In the very same order from which Mr. Denney quoted his statement that he alleged required injection of intraMTA pricing into this proceeding, the FCC clearly affirmed its MTA rule and how it must be applied. In that order the FCC was unambiguous that access rates determined in proceedings such as the instant case cannot apply to intrastate, intraMTA traffic: specifically, the FCC states that, "the *T-Mobile Declaratory Ruling* does not purport to limit the states' general authority to regulate rates for intrastate traffic as preserved by section 2(b) of the Act, ***except that LECs cannot impose compensation obligations for non-access CMRS traffic pursuant to state tariff.***" (emphasis added). See *North County Communications Corp., (Complainant) v. MetroPCS California, LLC, (Defendant)*, File No. EB-06-MD-007, Order on Review, Released November 19, 2009, ¶14.

⁵⁴ Denney Direct at page 12.

1 **Q. IS THIS PROCEEDING THE PROPER PLACE TO ADDRESS THE CLECS'**
2 **CONCERNS OVER SPECIAL ACCESS?**

3 A. No, the concerns raised by Mr. Denney about special access are federal issues, not state
4 ones, and the CLECs are trying to rehash matters already resolved by the FCC. Here the
5 Joint CLECs want to complain about the FCC's 2005 decision to discontinue unbundled
6 access requirements for certain network elements like high-capacity loops and transport
7 (which the Joint CLECs can obtain pursuant to "special access" tariffs).⁵⁵ Likewise, they
8 want to argue they are somehow impaired without unbundled access to those elements at
9 the pre-2005 lower prices. But the FCC conducted lengthy proceedings on those issues,
10 and the Joint CLECs had ample opportunity to participate. The FCC decided that CLECs
11 were *not* impaired without unbundled access in those circumstances, and the D.C. Circuit
12 upheld the FCC's decision when certain CLECs appealed.⁵⁶ Having failed to convince
13 the FCC or the appellate court, the Joint CLECs cannot make this issue an Arizona
14 matter. In addition, it is inappropriate to inject special access into this proceeding, or
15 compare special access as an example of how switched access rates must be determined.

16 **Q. THE JOINT CLECS ALSO ARGUE THAT THE COMMISSION SHOULD**
17 **NOT ALLOW CARRIERS TO ENTER INTO CONTRACTS FOR SWITCHED**
18 **ACCESS SERVICE.⁵⁷ HOW DO YOU RESPOND?**

19 A. I disagree. All the parties in this case, except the Joint CLECs, agree that carriers should
20 be allowed the flexibility to enter into switched access services contracts that enable them
21 to address critical business issues in a timely manner, without the need to go through

⁵⁵ See Denney Direct at page 27.

⁵⁶ *Re Unbundled Access To Network Elements*, CC Dkt. 01-338, *Order on Remand*, 20 FCC Rcd. 2533 (Rel. Feb 04, 2005); *Covad Communications Co. v. F.C.C.*, 450 F.3d 528 (D.C.Cir. 2006)

⁵⁷ Denney Direct at page 55.

1 lengthy regulatory proceedings. I have explained the reasons for this in detail in my direct
2 testimony,⁵⁸ and will not repeat them here.

3
4 **V. RESPONSE TO THE DIRECT TESTIMONY OF WILFRED SHAND ON**
5 **BEHALF OF COMMISSION STAFF**

6
7 **a. Staff's Suggestion that Arizona's Access Reform Policy Should be**
8 **Developed in Stages that will Skip Qwest in First Round**
9

10 **Q. DOES STAFF AGREE THAT INTRASTATE ACCESS REFORM IS NEEDED IN**
11 **ARIZONA?**

12 A. Yes. Staff correctly believes that public interests will benefit from access reform.⁵⁹ Like
13 Qwest, Verizon, and ALECA, however, Staff suggests using Qwest's rate as the target, a
14 proposal that precludes achieving comprehensive reform with interstate parity that will
15 benefit Arizona consumers. Even the Staff's witness concedes that Staff's proposal --
16 which excludes Qwest from access reform -- is only "a reasonable step in the move
17 toward consistency with interstate rates."⁶⁰ Staff's proposal does differ from that of
18 Qwest, Verizon and ALECA in one important respect: by stating that "...this is a
19 reasonable second in the move toward consistency with interstate rate...." and that
20 "...Staff is not recommending further reductions to Qwest's intrastate switched access
21 rates as a result of this docket...." Staff appears to leave open the possibility that Qwest's
22 rates could be reformed in a future docket.⁶¹

⁵⁸ See Dr. Oyefusi Direct at page 50 to 51.

⁵⁹ See Shand Direct at p.9. According to Staff, there are four benefits that would be derived from access reform: 1) Price Efficiency; 2) Reduction of arbitrage opportunities; 3) Elimination of differences in rates that occur because of regulatory decisions; 4) Establishment of more consistent and rational intrastate switched access rates.

⁶⁰ See Shand Direct, Executive Summary.

⁶¹ See Shand Direct at page 2, lines 18 to 21.

1 **Q. STAFF ARGUES THAT BECAUSE QWEST'S ACCESS RATES HAVE BEEN**
2 **REDUCED TO SOME EXTENT IN THE PAST,⁶² QWEST SHOULD BE GIVEN**
3 **A FREE PASS IN THIS PROCEEDING. WHY IS THIS NOT A LEGITIMATE**
4 **REASON TO POSTPONE REFORM OF QWEST'S RATES TO ANOTHER**
5 **DOCKET?**

6 A. As I stated earlier in responding to Qwest, Verizon and ALECA, the Commission should
7 not give a free pass to Qwest, which is the largest LEC in Arizona. Dr. Aron, in her
8 accompanying testimony, has given further reasons why Staff's proposal to delay reform
9 of Qwest's access rates is wrong from an economic perspective.⁶³ The question in this
10 proceeding is not what carriers have done in the past, but whether their rates *today* are
11 just and reasonable. That is especially true of Qwest because Qwest has the largest access
12 volumes in Arizona, and its high access rates do the most harm to consumers and
13 competition even if Qwest's rates are, relatively speaking, lower than other carriers that
14 have much smaller volume.

15 I will also add here that the Qwest/Staff proposal would lead to inconsistent
16 policies for different parties, will not achieve all of the benefits assumed by Staff, and
17 will not resolve the problems associated with interstate-intrastate rate disparities. The
18 amount of *past* access reductions by any one carrier should not discourage the
19 Commission from adopting a policy that will, going forward, promote consumer welfare,
20 facilitate competition, and achieve the needed interstate parity in Arizona. Nor should it
21 influence the Commission to leave the largest carrier, whose access rates do the most
22 harm, out of reform. Simply put, allowing Qwest to escape access reform at this time, as
23 Staff and Qwest suggest, would mean that more than

⁶² See Id. at pp. 2-3.

⁶³ See accompanying testimony of Dr. Debra J. Aron at Section VIII.

1 **BEGIN HIGHLY CONFIDENTIAL [REDACTED] END HIGHLY CONFIDENTIAL**

2 percent of Arizona access minutes (the proportion that traverses Qwest's network) will
3 not be affected one bit by Staff's proposed access reform. Under the Qwest/ Staff
4 proposal, access rates would be reduced only for the minority of access minutes carried
5 by other LECs – and even for those LECs, intrastate access rates would still diverge from
6 their corresponding interstate levels.

7 Thus, Staff and Qwest would leave a critical policy question unanswered and a
8 critical goal unachieved, i.e. whether (how) the intrastate rates of all the Arizona ILECs
9 should be set at parity with their corresponding interstate rates so that the problems of
10 interstate-intrastate rate disparities can be eliminated. As I discussed earlier, access
11 reform should not be about (or favor) any one company, it should be about the consumers
12 and public interest and affect or apply to all carriers equally. The partial reduction that
13 Staff referenced is not a good reason for skipping Qwest: whatever reductions Qwest has
14 made in the past, Qwest's rate *today* is unreasonable, harmful to competition, efficiency,
15 and Arizona consumers. If anything, it means that reform should be *easier* for Qwest
16 because it already has a head start on reform and will be impacted less by access revenue
17 reductions.

18 **Q. WOULD THE ACCESS REVENUE REDUCTION FOR QWEST BE LARGER**
19 **THAN FOR OTHER CARRIERS?**

20 **A.** Not really. It is true that in raw dollars, the reduction in Qwest's revenues will be larger
21 than for other LECs if the Commission adopts interstate-intrastate parity for all LECs, as
22 it should. That should not be a surprise, since Qwest carries the largest proportion of
23 intrastate minutes on its Arizona network. But Qwest also has the largest customer base,

1 so its reduction in access revenues per customer is quite modest, and rebalancing that
2 reduction in access revenues will be very simple. By my calculation, if Qwest were to
3 recover the *entire* access reduction by increasing its local service rates, the resulting
4 increase in local service rates would be only 75 cents per month, and the resulting
5 monthly rate (an average monthly rate of \$13.93) would certainly remain affordable.
6 Bear in mind, too, that AT&T proposes that this option as an opportunity and not a
7 mandate, and assumes that Qwest would choose that option to recover the *entire* access
8 reduction through rebalancing local rates, since the amount of access reduction per line is
9 small and would not require an increase that is likely to reach any reasonable benchmark
10 level. Obviously, Qwest may have other options, like cost savings, that it is free to
11 choose, and in that case the increase in its local rates would be lower still. The final
12 decision on which option works rests with Qwest, since Qwest knows its own business
13 best.

14 **Q. WHAT IF THE COMMISSION DOES DECIDE TO USE QWEST'S ACCESS**
15 **RATES AS A STEP TOWARDS FULL REFORM?**
16

17 A. As I have explained, the Commission should not give Qwest an exemption from
18 reform, but if the Commission did decide to use Qwest's rates as a step towards
19 comprehensive reform, it should adopt a single access reform policy that would clearly
20 chart out the final destination and the path that carriers will take to that final destination,
21 i.e. spell out where the rates will ultimately go, and the stages or steps that must be
22 travelled as expressed in Staff's testimony. If the Commission simply takes one step
23 towards reform *without* saying anything about the desired end result, it would have to
24 start all over from square one to implement additional reforms. The New Jersey Board
25 clearly spelled out its process and goals for reform in its February 1, 2010 final order. In

1 that decision, the Board clearly stated that its policy for access reform was reaching
2 interstate parity by all ILECs and capping all CLECs at the ILECs' levels, and then laid
3 out a clear implementation process that will get all LECs to that policy position over a
4 three-year transition period (much shorter than the CLECs have suggested in this case).
5 The New Jersey Board did not play favorites for any one particular carrier; rather it stated
6 clearly its policy and tailored implementation to only reflect any reasonable or practical
7 concerns expressed by parties that either opposed reform or advocated delay.

8 **Q. WHAT POLICY HAS STAFF SUGGESTED FOR THE ALECA MEMBERS AND**
9 **THE CLECS?**

10 A. Staff proposes that Qwest's current intrastate rate should be used as the target to which
11 the ALECA members' and CLECs' intrastate rates will be reduced. This suggestion
12 suffers from the same flaws that I discussed in response to Qwest and ALECA witnesses:
13 if adopted, the Commission and parties will devote a great deal of time and work to
14 implementing a proposal that still falls short of comprehensive reform with interstate
15 parity in Arizona. The bulk of the problems Staff claims it wants to solve will still
16 remain and the consumer benefits Staff anticipates will not be achieved.

17 **Q. IN LIGHT OF THIS POINT, HOW SHOULD STAFF'S PROPOSAL BE**
18 **AMENDED IN CASE THE COMMISSION DECIDES TO ADOPT IT AS AN**
19 **ALTERNATIVE TO AT&T'S PROPOSAL?**

20 A. Before I propose any amendments, I first reiterate that Staff's proposal will delay the
21 consumer benefits that would be produced by full reform. To the extent the Commission
22 decides to adopt Staff's proposal, it, like the New Jersey Board, must first clearly
23 proclaim its overall policy for access reform: reduction of intrastate rates to interstate
24 levels that will equally apply to all ILECs, including Qwest, and with all CLECs' charges

1 capped at the ILECs' levels. The commission may then consider whether any
2 circumstances Staff explains support implementing its policy in stages. For example,
3 instead of using Qwest rate as target, the Commission should set interstate parity as its
4 goal and then require all LECs (except Qwest) to implement that policy immediately
5 under the procedure I explained in my direct testimony, and briefly delay implementation
6 by Qwest until the Commission's pending proceeding to review Qwest's Renewed Price
7 Regulation Plan (T-01051B-03-054). Should the Commission wish to pursue that option,
8 AT&T suggests that the timing and process for its review of Qwest's Price Regulation
9 Plan be clearly stated, in this order, so that the Commission does not leave any
10 uncertainty with regard to how the reform of Qwest's intrastate access rates will be
11 addressed.

12 However, AT&T stresses that it is not amending its original proposal that all
13 LECs' intrastate access charges be reformed now. AT&T believes it is much more
14 efficient if the Commission establishes one policy to achieve access reform for all LECs
15 now, and implements that policy immediately for all carriers, including Qwest. As many
16 parties in this proceeding have observed, access reform is long overdue.⁶⁴

17 **b. Staff Suggests that the Commission Consider Adopting**
18 **Procedures to enable Immediate Implementation of Access**
19 **Reform.**
20

21 **Q. WHAT DOES STAFF BELIEVE WILL BE REQUIRED BEFORE CARRIERS**
22 **COULD DRAW FROM AUSF?**
23

24 **A.** Staff suggests that ALECA members (ILECs) should file rate cases, to comply with R14-
25 2-103 requirements, before they can draw access replacement revenue from AUSF. Staff

⁶⁴ Staff admits that its proposal "is a reasonable second in the move toward consistency with interstate rates." See Shand Direct at page 2.

1 appears concerned that without requiring these rate cases the Commission will be forcing
2 customers already paying \$24.46 per month retail rate to subsidize companies charging
3 retail rates as low as \$9.25 per month.⁶⁵ That will be inequitable, according to Staff.

4 **Q. HOW DO YOU RESPOND?**

5 A. AT&T agrees with Staff that the existing artificial imbalance of retail rates among
6 carriers across the state should be reduced as much as possible. In my direct testimony, I
7 expressed a similar concern that Arizona consumers who contribute the most to the
8 AUSF often face higher retail rates and, in general, significantly higher telephone bills,
9 while the customers of carriers that receive AUSF have significantly lower retail rates
10 and telephone bills. However, AT&T believes that the bulk of the inequity described by
11 Staff can be reduced without involving the complex and time consuming process of rate
12 cases that could unnecessarily delay the implementation of access reform.⁶⁶ Staff, too,
13 realizes that time is of the essence and suggests procedures to allow access reform to
14 occur immediately.

15
16 **Q. DO YOU AGREE THAT ACCESS REFORM IS URGENTLY NEEDED?**

17
18 A. Yes. In my direct testimony and here, I have explained the serious problems and
19 consumer harm produced by the current high level of intrastate switched access charges
20 in Arizona. I agree that the Commission should work toward developing procedures to
21 adopt much needed intrastate switched access reform as soon as possible, and that reform

⁶⁵ Staff states that the ALECA residential retail rates range from \$9.25 to \$24.46 per month and claims that "it would be inequitable to require ratepayers with a \$24.46 monthly rate to provide an AUSF surcharge subsidy to a company and its ratepayers whose monthly local service rate is, for example, \$9.25." See Shand Direct at p. 18. Staff claims that the R14-2-103 filing is required for the Commission to ensure companies are providing service at reasonable rates.

⁶⁶ Staff has suggested a schedule for the R14-2-103 rate cases for all ALECA members with the shortest duration of about 12 months and the longest duration of 42 months, after a decision in this docket. See Shand Direct at pages 27 to 28.

1 should eliminate interstate-intrastate rate disparities, promote efficiency, apply to all
2 carriers equally, and encourage competition. Only AT&T's proposal will ensure that
3 outcome. Other parties' proposals to omit Qwest or to reduce the ALECA members'
4 intrastate rates to disparate levels relative to their interstate rates will not.⁶⁷

5 **Q. DOES AT&T HAVE SPECIFIC SUGGESTIONS FOR AUSE RULES**
6 **REVISIONS?**

7 A. Yes. They are attached to this testimony as OAO Reply Exhibit C.
8

9
10 **c. Staff's Proposal to adopt Benchmark on a Carrier-by-Carrier**
11 **Basis will Cause Unnecessary Complexities and Delay.**
12

13 **Q. WHAT WAS STAFF'S RECOMMENDATION REGARDING THE ROLE OF**
14 **THE RETAIL RATE BENCHMARK?**
15

16 A. Staff opposes implementation of a statewide benchmark as AT&T and Qwest have
17 suggested, claiming that individual LEC circumstances differ and that the statewide
18 benchmark will not allow the Commission "flexibility to address each company and its
19 ratepayers on an individual company basis..." and that "statewide benchmark ignores the
20 disparate costs of providing service."⁶⁸ Although its contention was not explained in
21 detail, Staff supports retail rate benchmarks determined on an individual company basis.

22
23 **Q. HOW DO YOU RESPOND?**
24

25 A. Staff appears to be concerned about the significant disparities in the Arizona LEC retail
26 rates, but, unfortunately, opposes the solution that will equalize those rates in the most
27 reasonable manner. Staff has not explained how individual company benchmarks will

⁶⁷ As I discussed above, for example, the interstate-intrastate rate disparities for all the Arizona carriers will still remain under ALECA-Qwest proposal.

⁶⁸ See Shand Direct at page 16.

1 eliminate inequities in retail rates. Carrier-by-carrier benchmarks are not likely to be the
2 same, and therefore the retail rate disparities would still exist. In contrast, I offered a
3 proposal in my direct testimony, with detailed illustrations, to close the retail rate range,
4 and I addressed Staff's concern that consumers already paying higher retail rates should
5 not continue to heavily subsidize those currently paying lower retail rates.⁶⁹

6 Also, I explained that AT&T's proposal to close the gaps between urban and rural
7 rates is consistent with the Congressional universal service principle that rates should be
8 reasonably comparable for similar services in urban and rural areas.⁷⁰ I reiterate here that,
9 not only would the single statewide benchmark save the Commission a great deal of time
10 and work, it helps to ensure this reasonable comparability. Individual carrier-specific
11 benchmarks would not.⁷¹

12
13 **VI. RESPONSE TO DIRECT TESTIMONY OF DR. BEN JOHNSON ON**
14 **BEHALF OF RESIDENTIAL UTILITY CONSUMERS' OFFICE**
15

16 **Q. WHAT HAS RUCO'S WITNESS DR. BEN JOHNSON SUGGESTED THE**
17 **COMMISSION SHOULD DO IN THIS CASE?**
18

19 A. Dr. Johnson agrees with AT&T and the other parties that access reform is necessary in
20 Arizona, but he does not specifically articulate which policy RUCO or he wants the
21 Commission to adopt to achieve the reform. He only suggests some guidelines that he
22 alleges will provide a balanced policy approach, and he generally cautions that the
23 Commission should not implement access reform in an extreme manner that will harm
24 consumers. As Dr. Aron and I have explained in our direct testimonies, AT&T's proposal

⁶⁹ See Dr. Oyefusi Direct at page 56; also *citing* Dr. Aron Direct, Section IV(D).

⁷⁰ See Dr. Oyefusi Direct, citing 47 U.S.C. § 254(b)(3).

⁷¹ Individual carrier-by-carrier benchmark process is also deficient because it would task the Commission's time and resources.

1 is the only balanced approach in this case. Unlike the other parties, AT&T's proposal to
2 reduce all ILECs' intrastate switched access rates to their corresponding interstate levels,
3 and cap the CLECs' intrastate charges at the competing ILECs' rates ensures no carrier
4 (including AT&T's LEC subsidiaries in Arizona) escapes access reform and allows
5 consumers to receive the most benefit. Also, I have suggested gradual rebalancing to
6 retail pricing and therefore have addressed the concern expressed by Dr. Johnson to avoid
7 extreme changes to the retail rates paid by consumers.⁷²

8 Dr. Aron responds in greater detail to a number of other comments in Dr. Johnson's
9 testimony.

11 VII. CONCLUSION AND RECOMMENDATION

12 Q. IS THERE ANY REASON TO DELAY OR DEFER SWITCHED ACCESS 13 REFORM IN ARIZONA?

14 A. None whatsoever. As I showed in my Direct Testimony, there are many reasons why
15 substantial access reform should be ordered now:

- 16 1. High intrastate access rates are harming consumers and competition;
- 17 2. The straightforward approach AT&T proposes is workable, and modest retail
18 pricing flexibility and AUSF support in limited instances would easily offset the
19 decrease in revenues the LECs would face if intrastate access rates were reduced
20 to intrastate levels; and
- 21 3. Comprehensive access reform has already been delayed for many years while the
22 LECs have continued to collect excessive charges that can no longer be sustained
23 in the new competitive environments.

⁷² See Dr. Oyefusi Direct at pages 63 to 68.

1 The Commission should allow no further delay. Rather, it should move ahead promptly
2 and order an immediate reduction of the LECs' intrastate switched access rates to
3 interstate levels, so that Arizona can join New Jersey and many other states that have
4 given the same benefits to their consumers.

5 **Q. DOES THIS CONCLUDE YOUR REPLY TESTIMONY?**

6 **A. Yes it does.**

EXHIBIT A

OA0 REPLY EXHIBIT A
CONTAINS ALECA
CONFIDENTIAL DATA

ADOPTING QWEST'S INTRASTATE RATES AS THE TARGET FOR ARIZONA
ACCESS REFORM WILL NOT ELIMINATE RATE DISPARITIES

	Current Pricing Structure			Qwest's Proposed Pricing Structure			
	Current Composite Intrastate Access Rate	Current Composite Interstate Access Rate	Current Intra Disparities	Proposed LEC Rates at Qwest Target	Is Qwest Target Higher or Lower than LEC Interstate?	If Lower, Percent Less Than Interstate	If Higher, Percent More Than Interstate
ALECA Members							
TABLE TOP TELEPHONE COMPANY							
SOUTHWESTERN TEL CO							
COPPER VALLEY TELEPHONE, INC.							
ARIZONA TELEPHONE COMPANY							
VALLEY TEL COOP INC - AZ							
MIDVALE TELEPHONE EXCHANGE, INC - AZ							
SOUTH CENTRAL UTAH TELEPHONE ASSOC							
ACCIPITER COMM, INC. (ZONA COMM)							
CITIZENS FRONTIER-RURAL							
CITIZENS FRONTIER-WHITE MTN							
CITIZENS TELECOM NAVAJO COM CO - AZ							
Non-ALECA Members							
RIO VIRGIN TELEPHONE COMPANY							
VERIZON							
min (ALECA)							
max (ALECA)							

Confidential material has been redacted.

Confidential material has been redacted.

Confidential material has been redacted.

Source/Notes:

Composite Intrastate Rate for Rio Virgin based on switched access rate elements in publicly available access tariffs, and interstate based on 2009 annual filing at FCC.
Composite Intrastate Rate for ALECA based on response to AT&T 3-1, and interstate is based on 2009 annual filing at the FCC
Assume 10 miles for mileage sensitive transport rates.
Traffic pattern assumed for public tariff blending: 20% tandem routed, 80% direct trunked (with a 1.35% switched dedicated factor)
Average Unit cost for RIO Virgin assumes the originating rates see 50% of the local switching minutes.

EXHIBIT B

THE ARIZONA CLECS ARE NOT “MOM AND POP” OPERATIONS, AND THEY SHOULD BE ENCOURAGED TO FUNCTION ON THEIR OWN MERIT AS OTHER COMPANIES DO IN A COMPETITIVE MARKET.

The CLECs participating in this proceeding serve primarily medium to large businesses, government, wholesale markets, and content markets in metropolitan areas. Thus, none could justifiably claim that it needs subsidies to survive, because business services have been traditionally priced higher than residential services and generally have been the source of, and not the recipients of, any subsidies. Moreover, these carriers are hardly “mom and pop” operations that require (or deserve) a different treatment from traditional LECs. Below is a brief summary of their profiles.

1. Level 3 - Level 3 is a Fortune 500 corporation¹, and substantial corporate entity that operates in 21 countries. It has enough fiber to wrap around the globe more than three times. Level 3’s revenues have grown from \$1.5 billion in 2005 to \$4.3 billion in 2008.²

2. XO Communications - XO Communications provides services on four continents. Its network reaches globally from the United States to countries in North America, South America, Europe and the Asia/Pacific region. XO Communications boasts more than 1 million miles of metro fiber—enough to circle the globe 45 times or get to the Moon and back twice. XO Communications reported \$1.5 Billion in 2008 annual revenue.³

¹ Level 3 was ranked # 465 in the 2007 ratings, although they ranked slightly lower at #529 in 2008. <http://money.cnn.com/magazines/fortune/fortune500/2007/snapshots/2144.html>

² Level 3 Annual Report 2008 10K, page 61 <http://lvl.client.shareholder.com/secfiling.cfm?filingID=1047469-09-2002>

³ XO Communications corporate website <http://www.xo.com/about/Pages/overview.aspx>

3. PAETEC - PAETEC acquired US LEC Corp. and Allworx Corp. in 2007 and McLeodUSA in 2008 to grow its reach to about 83 of the top 100 U.S. metropolitan statistical areas across 39 states⁴. PAETEC reported \$1.6 Billion in 2008 annual revenue.⁵

In a recent Case Study by Forrester Research, Inc., it is noted that PAETEC reports a 99.7% month-over-month customer retention rate.⁶ PAETEC also reports that decreases in access fee revenue and reciprocal compensation for 2006, 2007, and 2008 was principally due to a shift in product mix⁷ and, as recently as May 18, 2009, PAETEC reports that "reductions in access fees have been overtaken by significant growth in data and integrated services including local and long distance."⁸

4. Integra Telecom - Integra Telecom, which comprises of Eschelon Telecommunications, Mountain Telecommunications, Electric Lightwave, Advanced Telecommunications⁹, is a holding company for CLECs that serve 200 business communities in 11 western states. Its 160,000 fiber miles and 4700-mile, long haul network make it the fourth largest CLEC in the U.S. It is privately held but boasted \$470 million annual revenue in 2007 and nearly \$700 million for 2008.¹⁰ In fact, between 2004 and 2007, Integra achieved revenue growth of 241.8%.¹¹

⁴ According to information in PAETEC's website, Market Served.

http://www.paetec.com/strategic/markets_served.html

⁵ PAETEC Annual Report 2008 10K, page 39. http://phx.corporate-ir.net/phoenix.zhtml?c=190031&p=irolsec&secCat01.1_rs=21&secCat01.1_rc=10

⁶ Forrester Research, Inc. Case Study: "*PAETEC's Customer-Focused Strategy Captures US SMBs*", by Michele Pelino with Heidi Lo and Ellen Daley, May 30, 2008.

⁷ PAETEC 2008 10-K, p. 46. http://phx.corporate-ir.net/phoenix.zhtml?c=190031&p=irolsec&secCat01.1_rs=21&secCat01.1_rc=10

⁸ *Id.*, page 39.

⁹ Only three of these subsidiaries are involved in the Arizona case, i.e., Eschelon Telecommunications, Mountain Telecommunications, and Electric Lightwave.

¹⁰ Integra Telecom corporate website: http://www.integratelecom.com/about/company_information.php

¹¹ Integra Telecom corporate website: http://www.integratelecom.com/about/company_milestones.php

5. Cox Communications - Cox Communications is a subsidiary of Cox Enterprises which claims to be a "Top 10 national player, based on revenues, in every major business category" where it competes.¹² Cox is the 3rd largest cable entertainment and broadband services provider in the country with over 6 million customers and over 22,000 employees. Cox claims to have invested more than \$16 billion through infrastructure upgrades to deliver video, phone and high-speed internet service. Cox is privately held and reports revenues exceeding \$15 billion for its major subsidiaries.¹³

¹² Cox Communications corporate website: <http://ww2.cox.com/aboutus/our-story.cox>

¹³ Cox Enterprises corporate website:
http://www.coxenterprises.com/corp/operating_companies/operatingcompanies.htm?Vermenu=operatingcompanies

EXHIBIT C

ARIZONA ADMINISTRATIVE CODE
TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS;
SECURITIES REGULATION
CHAPTER 2. CORPORATION COMMISSION FIXED UTILITIES
ARTICLE 12. ARIZONA UNIVERSAL SERVICE FUND

R14-2-1201. Definitions

In this Article, unless the context otherwise requires, the following definitions shall apply:

1. "Administrator" is the person designated pursuant to R14-2-1212 to administer the AUSF and perform the functions required by this Article.
2. "Arizona Corporation Commission" or "Commission." The regulatory agency of the state of Arizona having jurisdiction over public service corporations operating in Arizona.
3. "Arizona Universal Service Fund" or "AUSF" is the funding mechanism established by this Article through which surcharges are collected and support paid in accordance with this Article. The AUSF shall consist of two separate support funds: the "AUSF High Cost Support Fund" and the "AUSF Access Revenue Replacement Support Fund."
4. ~~"AUSF Support"~~ "AUSF High Cost Support" is the amount of money, calculated pursuant to this Article, which a provider of basic local telephone exchange service is eligible to receive from the AUSF High Cost Support Fund pursuant to this Article.
5. ~~"AUSF Support"~~ "AUSF High Cost Support Area" is the geographic area for which a local exchange carrier's eligibility to receive ~~AUSF support~~ AUSF High Cost Support is calculated.
6. "Basic local exchange telephone service" is telephone service that provides the following features:
 - a. Access to 1-party residential service with a voice grade line;
 - b. Access to touchtone capabilities;
 - c. Access to an interexchange carrier;
 - d. Access to emergency services, including but not limited to emergency 911;
 - e. Access to directory assistance service;
 - f. Access to operator service;
 - g. Access to a white page or similar directory listing; and
 - h. Access to telephone relay systems for the hearing and speech impaired.

7. "Benchmark rates" for a telecommunications services provider are those rates approved by the Commission for that provider for basic local exchange telephone service, plus the Customer Access Line Charge approved by the Federal Communications Commission.

8. "Commercial Mobile Radio Service" is any radio communication service carried on between mobile stations or receivers and land stations, or by mobile stations communicating among themselves, that is provided for profit and that makes available to the public service that is connected to the public switched network.

9. "Comparability standard rate" is the rate level set by the Commission and used to compute the revenue that may be recovered by local exchange carriers from their end-user customers for residential and business local exchange services in order to offset revenues lost as a result of the Commission's reform of intrastate switched access rates. This revenue may not be recovered from a fund. "Conversion Factor" is a multiplier that is used to convert a quantity of interconnecting trunks for both wireless and wireline customers into equivalent access lines, for the sole purpose of developing Category 1 surcharges. The value of the Conversion Factor shall be 10 until completion of the review provided for in R14-2-1216.

10. "Interconnecting Trunk" is a 1-way or 2-way voice grade or equivalent voice grade switched message transmission channel furnished by a local switched access provider to a provider of wireless services or to a wireline customer of such local switched access provider to interconnect the provider of wireless services or wireline customer to the public switched network.

11. "Intermediate Local Exchange Carriers" are incumbent providers of basic local exchange telephone service with more than 20,000 access lines but fewer than 200,000 access lines in Arizona.

12. "Large Local Exchange Carriers" are incumbent providers of basic local exchange telephone service serving 200,000 or more access lines in Arizona.

13. "Small Local Exchange Carriers" are incumbent providers of basic local exchange telephone service with 20,000 or fewer access lines in Arizona.

14. "Total Service Long Run Incremental Cost" is the total additional cost incurred by a telecommunications company to produce the entire quantity of a service, given that the telecommunications company already provides all of its other services. Total Service Long Run Incremental Cost is based on the least cost, most efficient technology that is capable of being implemented at the time the decision to provide the service is made.

15. "U.S. Census Blocks" are geographic areas defined by the U.S. Department of Commerce. The areas, which define the way in which census data is aggregated, generally contain between 250 and 550 housing units.

R14-2-1202. Calculation of ~~AUSF Support~~ AUSF High Cost Support

A. The amount of ~~AUSF support~~ AUSF High Cost Support to which a provider of basic local exchange telephone service is eligible for a given ~~AUSF support~~ AUSF High Cost Support area shall be based upon the difference between the benchmark rates for basic local exchange telephone service provided by the carrier, and the appropriate cost to provide basic local exchange telephone service as determined by the Commission, net of any universal service support from federal sources.

B. For a small local exchange carrier, the ~~AUSF support~~ AUSF High Cost Support area shall include all exchanges served by the local exchange carrier in Arizona. The appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support for a small local exchange carrier shall be the embedded cost of the incumbent provider. For any request for ~~AUSF support~~ AUSF High Cost Support by a small local exchange carrier filed more than three years after the effective date of this Article, the ~~AUSF support~~ AUSF High Cost Support area shall be the geographic areas as determined by the Commission.

C. For an intermediate local exchange carrier, the ~~AUSF support~~ AUSF High Cost Support area shall be either all exchanges in Arizona served by that carrier, or such other support area as may be approved by the Commission. The appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support for an intermediate local exchange carrier shall be the embedded cost of the incumbent provider. For any request for ~~AUSF support~~ AUSF High Cost Support by an intermediate local exchange carrier filed more than three years after the effective date of this Article, the ~~AUSF support~~ AUSF High Cost Support area shall be geographic areas as determined by the Commission, and the appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support shall be the Total Service Long Run Incremental Cost of the incumbent provider. In the event that the FCC adopts a somewhat different forward-looking costing methodology and/or a different geographic study/support area for the Federal universal service fund program, a local exchange carrier may request a waiver from this rule in order to utilize the same cost study methodology and/or geographic study areas in both jurisdictions.

D. For a large local exchange carrier, the ~~AUSF support~~ AUSF High Cost Support area shall be U.S. census block groups, and the appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support shall be the Total Service Long Run Incremental Cost. In the event that the FCC adopts a somewhat different forward-looking costing methodology and/or a different geographic study/support area for the Federal universal service fund program, a local exchange carrier may request a waiver from this rule in order to utilize the same cost study methodology and/or geographic study areas in both jurisdictions. Any request for ~~AUSF support~~ AUSF High Cost Support by a large local exchange carrier shall include a Total Service Long Run Incremental Cost study, or cost study based on FCC adopted methodology, of basic local exchange service. The cost study shall be developed and presented in a manner that identifies the cost for the individual support areas for which AUSF funding is being requested.

R14-2-1202A. Calculation of AUSF Access Revenue Replacement Support.

A. Purpose of AUSF Access Revenue Replacement Support.

The purpose of the AUSF Access Revenue Replacement Fund is to facilitate the reduction of implicit subsidies formerly contained in intrastate switched access rates, and to make such subsidies explicit to the extent subsidies for basic local exchange service are to be maintained for the promotion of universal service at affordable rates.

B. Amount of Support.

The amount of AUSF Access Revenue Replacement Support that an eligible provider of basic local exchange service may obtain shall be computed on an annual basis as the difference between (1) the eligible provider's "access shift" as calculated in part (1) of this rule, and (2) the eligible provider's "imputed access replacement revenue," as calculated in part (2) of this rule.

1. An eligible provider's "access shift" shall be equal to that provider's intrastate access minutes for a base period to be determined by the Commission, multiplied by the difference between the average per-minute intrastate access rate and the carrier's average per-minute interstate access rate for that base period.

(a) An eligible provider's average per-minute intrastate access rate shall be computed as the provider's total intrastate switched access revenues for the base period, divided by the provider's total intrastate switched access minutes for the base period.

(b) An eligible provider's average per-minute interstate access rate shall be computed as the provider's total interstate switched access revenues for the base period, divided by the provider's total interstate switched access minutes for the base period.

2. An eligible provider's "imputed access replacement revenue" shall be equal to the difference between comparability standard rates established by the Commission and the provider's basic residential and business exchange rates in effect as of December 31, 2009, multiplied by the number of residential and business lines served by the carrier as of December 31, 2009, with the number of business lines to include each line providing the customer with an Arizona place of primary use, including lines delivered through tariffs other than the basic business local exchange service tariff. To the extent an eligible provider's basic residential or business exchange rate in effect as of December 31, 2009 exceeds the comparability standard rate, that actual rate shall be used in place of the applicable comparability standard rate in computing the provider's imputed access replacement revenue.

R14-2-1203. Request for AUSF Support

A provider of basic local exchange telephone service may request that the Commission authorize AUSF support with a filing under R14-2-103 or other method as the Commission may prescribe, and upon compliance with all applicable rules set forth in R14-2-1101 through R14-2-1115. A request for AUSF support shall include a statement describing the need for such funding. The Commission shall determine the appropriate cost of providing basic local exchange service for each ~~AUSF support~~ AUSF High Cost Support area for which ~~AUSF support~~ AUSF High Cost Support is requested and shall calculate in accordance with R14-2-1202 the amount of ~~AUSF support~~ AUSF High Cost Support, if any, to which the applicant is entitled. The Commission shall also determine in accordance with R14-2-1202A the amount of AUSF Access Revenue Replacement Support, if any, to which the applicant is entitled.

R14-2-1204. Funding of the AUSF

A. The AUSF shall be funded in accordance with this Article by all telecommunications service providers that interconnect to the public switched network. Within 30 days of the effective date of this Article, and thereafter on or before October 1 of each year, each telecommunications provider shall provide to the Administrator a list of all other telecommunications providers that interconnect to its facilities or network.

B. The AUSF shall be funded in a competitively neutral manner on the basis of intrastate telecommunications revenue, as described in R14-2-1205.

~~equally by toll and local customers of the providers of telecommunications services, and shall be assessed in the following manner:~~

~~1. Category 1—Providers of basic local exchange service, as discussed in R14-2-1204(B)(1)(a), and other service providers as required under R14-2-1204(B)(1)(a)(i) or permitted under R14-2-1204(B)(3)(b), shall be considered providers of Category 1 service.~~

~~a. One half of the AUSF funding requirement will be collected through Category 1 service providers. Category 1 AUSF assessment will be based upon access lines and interconnecting trunks, and assessed by providers of local switched access as either an access line or interconnecting trunk surcharge. The “per access line” surcharge to be in place during a given year will be calculated by the Administrator using the total number of access lines and equivalent access lines deriving from interconnecting trunks that were in service for all Category 1 service providers on October 1 of the previous year. Access lines shall include business and residence lines, public access lines, and other identifiable access lines. All wireless providers including but not limited to paging and other Commercial Mobile Radio Service providers, that interconnect to the public switched network will contribute to the AUSF under the requirements of Category 1. The number of interconnecting trunks obtained from the local access provider by the wireless provider shall be utilized in conjunction with a Conversion Factor to determine AUSF support from such wireless provider by means of a surcharge on such interconnecting trunks. A wireless provider that fails to contribute to the AUSF as required by this Article shall be subject to termination of its interconnection arrangements pursuant to R14-2-1214(C).~~

~~b. On or before November 1 of each year, each Category 1 local switched access service provider shall provide to the Administrator the number of access lines and number of interconnecting trunks that were in service on October 1 of that year. The Administrator will use these numbers together with the Conversion Factor in calculating the per access line surcharge and per interconnecting trunk surcharge for the following year. The Administrator will multiply the total number of interconnecting trunks by the Conversion Factor to obtain an equivalent number of access lines for the purpose of calculating the surcharges.~~

~~2. Category 2—Providers of intrastate toll service, or other service providers as permitted under R14-2-1204(B)(3), shall be considered providers of Category 2 service and shall be assessed AUSF charges as follows:~~

~~a. One half of the AUSF funding requirement will be collected through Category 2 service providers. The Category 2 AUSF assessment will be based on total Arizona intrastate toll revenue, and assessed as a percent of revenue. The percent of revenue assessment to be in place during a given year will be calculated by the Administrator using the annual Arizona intrastate revenue for all Category 2 service providers for the previous year.~~

~~b. On or before November 1 of each year, each Category 2 service provider shall report to the Administrator the total Arizona intrastate revenue collected between August 1 of the current year and August 1 of the previous year. The Administrator will use this revenue so reported to calculate the AUSF assessment rate for the following year.~~

~~3. New telecommunications service providers.~~

~~a. Telecommunications providers that begin providing basic local exchange service after the effective date of this Article shall be assessed AUSF charges pursuant to R14-2-1204(B)(1). Telecommunications providers that begin providing toll service after the effective date of this Article shall be assessed AUSF charges pursuant to R14-2-1204(B)(2).~~

~~b. All other telecommunications service providers that interconnect to the public switched network and begin providing telecommunications service after the effective date of this Article, shall choose to be considered either a Category 1, Category 2, or both Category 1 and Category 2 service provider. Such election shall be made in writing to the Administrator within 30 days of beginning to provide telecommunications service in Arizona, with a copy to the Director of Utilities. Written concurrence of the Director of Utilities must be received by the Administrator for such selection to be effective. Such selection will be irrevocable for a period of at least three years.~~

~~4. A telecommunications provider that provides both Category 1 and Category 2 services shall be assessed AUSF charges pursuant to both R14-2-1204(B)(1) and R14-2-1204(B)(2).~~

R14-2-1205. Calculation of Surcharges

A. The Administrator will calculate the total AUSF support ~~AUSF High Cost Support and AUSF Access Revenue Replacement Support~~ due all local exchange carriers who have been granted AUSF support ~~such support~~ by the Commission. Administrative costs and audit fees will be added to this amount. The amount of any excess funds in the AUSF will then be subtracted to determine the total funding requirement. The surcharge rate shall be equal to the total annual funding requirement divided by the sum of intrastate retail telecommunications revenue for all contributing carriers in Arizona for the immediately preceding calendar year, and may be adjusted to account for any material deficit or surplus projected to exist at the start of the fund year.

B. Each contributing company's monthly contribution shall equal the state USF surcharge rate multiplied by its intrastate retail telecommunications revenues in Arizona for the month. ~~The funding requirements from Category 1 and Category 2 service providers will then be calculated. One half of the funding will be obtained from Category 1 providers through surcharges applied to access lines and interconnecting trunks in service. The other half will be obtained from Category 2 providers through surcharges on intrastate toll revenues.~~

~~**B.** For the purpose of determining the surcharges, the Administrator will develop growth factors to apply to the total reported access lines and toll revenues. Such growth factors will be calculated at 1/2 of the estimated annual percentage growth in access lines and in toll revenues.~~

~~**C.** Category 1 Surcharge. One half of the total annual AUSF support approved by the Commission for all eligible recipients will be obtained from Category 1 service providers. A monthly per access line surcharge and a monthly per interconnecting trunk surcharge required to obtain this funding will be calculated as follows:~~

- ~~1. Adding together the number of access lines and equivalent access lines for all Category 1 service providers, adjusted by the growth factor;~~
- ~~2. Dividing the total annual AUSF support approved by the Commission for all eligible recipients by 2 to obtain the portion of AUSF support required from Category 1 service providers;~~
- ~~3. Dividing the amount of Category 1 AUSF support calculated in subsection (C)(2) by the sum of access lines calculated in subsection (C)(1) to yield the per access line surcharge;~~
- ~~4. Dividing the per access line surcharge calculated in subsection (C)(3) by 12 to determine the monthly access line assessment;~~
- ~~5. Multiplying the surcharge obtained in subsection (C)(4) by the Conversion Factor to determine the monthly interconnecting trunk surcharge.~~

~~**D.** Category 2 Surcharge. One half of the total annual AUSF support approved by the~~

~~Commission for all eligible recipients will be obtained from Category 2 service providers. A percent of revenue surcharge required to obtain this funding will be calculated as follows:~~

- ~~1. Totalling the annual intrastate toll revenues of all Category 2 service providers, adjusted by the growth factor;~~
- ~~2. Dividing the total AUSF support approved by the Commission for all eligible recipients by 2 to obtain the portion of AUSF support required from Category 2 service providers;~~
- ~~3. Dividing the amount of Category 2 AUSF support requirement calculated in subsection (D)(2) by the total annual intrastate toll revenues calculated in subsection (D)(1) to arrive at a percentage of revenue surcharge.~~

~~EC.~~ Recipients of lifeline or other low-income support shall be exempt from paying a Category 1 surcharge.

R14-2-1206. Implementation

A. Any provider of telecommunications service may file either an AUSF tariff or price list, if appropriate, establishing a flow-through mechanism to collect the surcharge approved by the Commission and calculated by the Administrator.

B. On or before the 20th day of each month, each ~~Category 1 telecommunications service provider, including wireless providers,~~ responsible for collecting AUSF surcharges shall remit to the Administrator the AUSF surcharge; ~~including any surcharge on wireless providers,~~ collected by that provider during the preceding month. The ~~Category 1~~ provider shall submit such documentation of AUSF revenues from the AUSF surcharge as may be required by the Administrator.

C. Only carriers that are incumbent local exchange carriers, and have obligations to serve as a carrier of last resort as of October 1, shall be eligible to receive AUSF Support for the subsequent calendar year.

~~C. On or before the 20th day of each month, each Category 2 service provider responsible for collecting AUSF surcharges shall remit to the Administrator the AUSF surcharge collected by that provider during the third preceding month. The Category 2 provider shall submit such documentation of AUSF revenues from the AUSF surcharge as may be required by the Administrator.~~

~~D. Eligible recipients of AUSF support are:~~

~~1. Providers of telecommunications service engaged in providing basic local exchange telephone service in Arizona which have obtained a Commission order authorizing payments from the AUSF; and~~

~~2. Providers that become entitled to AUSF support based upon the provisions of R14-2-1206(E).~~

~~E. If the Commission approves AUSF support to a provider of telecommunications service for a defined area, such AUSF support shall also be available to competitive providers of basic local exchange service in the same defined area that are contributing to the AUSF, and that are willing to provide service to all customers in the specific AUSF support area as defined by the Commission. The AUSF support to which the competitive provider is eligible shall be calculated on a percustomer basis, at the same level at which the incumbent provider of telecommunications service receives AUSF support, and shall not result in an increase in the total AUSF support available for the specific census block groups or study area. If basic exchange service is provided through the resale of another carrier's local loop facilities, AUSF support will only be available to the retail service provider if AUSF support is not included in the wholesale price for the resold local service. This Section shall not apply to small local exchange carriers nor to the universal service support being received by any telecommunications service provider as of the effective date of this Article.~~

~~F. For small local exchange carriers and for any basic local exchange telephone service provider receiving universal service support as of the effective date of this Article, the AUSF support shall not be available to competitive providers of basic local exchange service prior to completion of the review provided for in R14-2-1216. Following completion of the review, AUSF support provided to small and intermediate local exchange carriers shall be available to all competitive providers of basic local exchange service in the same defined area that are contributing to AUSF, and that are willing to provide service to all customers in the specific geographic study area as defined by the Commission, unless otherwise ordered by the Commission.~~

~~G. Defined area, study area, geographic area, and support area mean the same area during the first three years of the effective date of this Article. After the first three years, they will still have the same meaning unless otherwise ordered by the Commission.~~

R14-2-1207. Calculation of Monthly Payments and the Associated Collections

-A.

~~For the monthly Category 1 AUSF payment, each provider of local switched access shall remit to the Administrator an amount equal to the number of access lines in service on the first day of the month, times the monthly surcharge per access line plus the number of interconnecting trunks in service on the first day of the month, times the monthly interconnecting trunk surcharge.~~

B. The monthly AUSF payment that each Category 2 provider shall remit to the Administrator is an amount equal to its monthly intrastate toll retail- telecommunications service revenue times the monthly surcharge percentage determined in accordance with R14-2-1205.

C. Payments must be received by the Administrator by the 20th day of each month. If the payment amount is greater than \$10,000, then it shall be wire transferred to the Administrator.

D. The Administrator shall enter into an appropriate non-disclosure agreement with each telecommunications service provider to assure that information necessary to allocate AUSF funding obligations and to calculate surcharges is reported, maintained, and used in a manner that will protect the confidentiality of company specific data. The Administrator shall not use confidential data for any purpose other than administering the AUSF.

R14-2-1208. Monthly AUSF Disbursements

A. AUSF disbursement shall be made 30 days following the date of AUSF collections.

B. The Administrator shall not make AUSF support payments to a provider of telecommunications service until the Administrator has received a copy of a Commission decision authorizing the provider to receive such support.

R14-2-1209. Procedures for Handling AUSF Rate Changes

A. ~~Category 1 and Category 2~~ AUSF surcharges shall be revised when the Commission authorizes new or revised AUSF payments to any provider of telecommunications service. The Administrator shall calculate the new AUSF flow-through surcharges in accordance with this Article, which surcharges shall become effective upon the Commission's approval of the new or revised AUSF payments.

B. An annual calculation to revise AUSF flow-through surcharges shall be made by the Administrator on ~~Dec~~November 1 of each year with an effective date the following January 1. The flow-through surcharges shall be calculated so that the total AUSF funding will equal the AUSF revenue requirements, plus administrative costs as well as any corrections and true-ups. No later than ~~Dec~~November 1 of each year, the Administrator shall provide notice to the Commission and all telecommunication service providers who pay into the AUSF of the flow-through surcharge rates for the following calendar year. By December 1, the Commission shall adopt a new surcharge rate for the following year and shall provide notice of that rate to all telecommunications providers that pay into the AUSF.

R14-2-1210. Statement of Participation of All Telecommunications Service Providers in the AUSF

A. Within 30 days of the effective date of this Article, each telecommunications service provider shall provide a letter to the Administrator acknowledging that provider's obligation under this Article to pay-collect and remit the proceeds of AUSF surcharges. Failure to provide such a letter shall be grounds for termination after written notice from the Administrator of the provider's interconnection with the public switched network.

B. Any telecommunications service provider which begins providing telecommunications service after the effective date of this Article shall, within 30 days of beginning to provide intrastate service in Arizona, provide a letter to the Administrator acknowledging that provider's obligation under this Article to make monthly payments for the local and/or toll portion, as appropriate, of the AUSF contribution in accordance with this Article. Failure to provide such a letter shall be grounds for denying to the provider interconnection with the public switched network.

R14-2-1211. Duties and Responsibilities of the AUSF Administrator

The Administrator shall:

1. Develop, obtain, and, on or before ~~Dec~~November 15 of each year, file with the Commission such information and documentation as the Administrator deems necessary for the establishment and calculation of the ~~Category 1 and Category 2~~ surcharges for the succeeding year. Such a filing shall also be made each time the Commission authorizes a change in the AUSF funding requirement.
2. Monitor the AUSF payments of all telecommunications providers.
3. Oversee the billing of AUSF surcharges.
4. Prepare the necessary forms to be used in reporting the AUSF collections and disbursements and maintain monthly records.
5. Coordinate the collection and disbursement of AUSF monies in accordance with this Article.
6. Prepare an annual report that provides a detailed accounting of the AUSF collections and disbursements and that identifies the annual cost of administration. The report shall be filed with the Commission on or before April 15 of each year.
7. Monitor procedures for auditing the AUSF collections and disbursements. The audit function shall be performed by an independent outside auditor.

~~R14-2-1212. Interim Administrator~~

~~US WEST Communications, Inc., will serve as interim Administrator of the AUSF and will perform the functions detailed herein that are required of the Administrator for a transition period until a private, neutral third party is appointed by the Commission to serve as Administrator of the AUSF. A neutral third party selected through the competitive bid process shall be appointed no later than July 1, 1997.~~

R14-2-1214. Enforcement of Collection of Delinquent AUSF Amounts

A. The Administrator shall issue past due notices to each provider of telecommunications service that is 15 days or more delinquent in submitting its AUSF payments to the Administrator. A copy of this notice shall be provided to the Commission.

B. AUSF support payments shall be withheld from any provider of telecommunications service that is delinquent in submitting its AUSF payments to the Administrator. Each provider of telecommunications service will be fully liable for any accrued interest owing on its AUSF contributions that remain unpaid for 30 days. Such delinquent AUSF payments will begin accruing interest at the rate of 1 and 1/2% per month beginning with the 31st day until such amount is paid in full along with all accrued interest.

C. ~~The local switched access service provider~~ Administrator shall promptly notify the Commission ~~and the Administrator~~ of the identity of any wireless provider which fails or refuses to pay its AUSF surcharge. Such notice shall also be directed to the wireless provider. If the wireless provider has not paid the amount due within 30 days of such notice, the interconnection ~~provider to such wireless provider~~ shall terminate the wireless provider's interconnection until the full amount together with all accrued interest, is paid in full (unless the payment is in bonafide dispute and the wireless carrier has paid the undisputed amount).

D. Failure by a telecommunications service provider to comply with the provisions of this Article may result in sanctions as determined by the Commission.

R14-2-1215. AUSF Annual Report

A. On or before April 1 of each year, the Administrator shall file with the Commission an annual report which shall summarize the preceding year activity and contain the following:

1. A statement of AUSF collections and disbursements.
2. A record of the total cost of administration of the AUSF.
3. Audit reports from the audits conducted during the year.

B. A copy of the annual report shall be provided to each provider of telecommunications service who contributes to the AUSF.

R14-2-1216. Review Process

A. Not later than three years from the effective date of this Article, the Commission staff shall initiate a comprehensive review of this Article and shall provide the Commission with recommendations regarding any necessary changes to the Article. Any interested party may also make such recommendations. The Commission shall consider these recommendations in such proceeding as the Commission deems appropriate.

B. The costs used to calculate AUSF funding levels for a given provider or ~~AUSF support~~ AUSF High Cost Support area shall be reviewed by the Commission at least every three years following the effective date for any authorized ~~AUSF support~~ AUSF High Cost Support for the provider or study area. The Commission may reduce the authorized funding level and require that the AUSF surcharge be recalculated on the basis of this review.

R14-2-1217. Supersession of Existing USF Mechanism

The universal service funding mechanism initially approved by the Commission in Decision No. 56639 (September 22, 1989) is superseded by this Article, except that any calculation, contribution or collection of, or entitlement to, universal service fund support approved by the Commission prior to the adoption of this Article shall remain in effect until otherwise ordered by the Commission or until the application of this Article leads to a different result.